

Regional Economic Forecasting Panel

Business Forecasts Northwest

A Short Term Forecast for 2006-09

Autumn 2006

Produced by The Regional Economic Forecasting Panel on behalf of the

Regional Intelligence Unit. www.nwriu.co.uk



INVESTING IN
englandsnorthwest

This report is published by the Northwest Regional Development Agency as part of its continuing commitment to inform the economic development of England's Northwest.

It has been produced by SQW Ltd and Cambridge Econometrics Ltd, economic development and forecasting consultancies, on behalf of the Northwest Regional Economic Forecasting Panel.

Whilst every effort has been made to ensure the accuracy of the material in this report neither the Panel, SQW Ltd, Cambridge Econometrics Ltd nor the NWDA Research Team can accept any responsibility for decisions based on the material that follows.

Further Information

If you require further information on the work of the Panel, please contact Nicola Christie.
Press enquiries should be addressed to Neil Roscoe.

Nicola Christie
Economist
Research Team, NWDA
nicola.christie@nwda.co.uk
01925 400293

Neil Roscoe
Senior Press Officer
NWDA
neil.roscoe@nwda.co.uk
01925 400232

Foreword

Like the UK, the Northwest economy has substantially recovered from a marked consumer-led slowdown in growth early last year. Following this, we expect steady economic growth of just over two and half per cent a year in the region in 2007, 2008 and 2009.

While the UK as a whole is still expected to grow slightly faster on average than the Northwest, our new forecast does suggest there may have been some narrowing in the underlying growth gap between the region and the UK. In any event, the prospect of economic growth over the next three years at rates above previous trends in the region and in the wider economy continues to represent a significant opportunity for business.

The main feature of our new business forecast is that recovery in 2006 is seen as stronger than we anticipated in the forecast we published in June 2006. However, the picture we show for growth over the next three years is not that much changed. An important consequence for business is that expected levels of output in the region and in the UK are therefore expected to be higher than we showed in June, potentially providing even better opportunities for sales.

It has been put to us that readers might find it helpful if we were to include notes about the points we feel that we should watch particularly carefully in monitoring the regional economy, and in preparing our forecasts. Such notes are included in this edition. Some of them concern structural issues, for instance several that affect the size of the workforce and potential skills constraints, to which we attach considerable importance, and to which we shall

return early next year when we revisit our view of the region's longer term prospects.

We have again provided an Executive Briefing in this edition of Business Forecasts Northwest. This is designed to be free standing so that readers can treat it as a summary and introduction to our forecasts, or download it from www.nwriu.co.uk, to forward to colleagues and others to give them the essence of our views.

There readers will also find copies of our other publications, including our revised report in the prospects of regional economy over the next twenty years, and the factors that we believe will influence its development relative to the UK as a whole.

While the Panel is independent of NWDA, we enjoy the support of the region's Regional Intelligence Unit, based in the Agency. We are grateful to the Unit for their support, for the knowledge they contribute, and for publishing our papers. We are also grateful to SQW Ltd and Cambridge Econometrics Ltd for the draft materials we have taken into account in preparing this forecast.

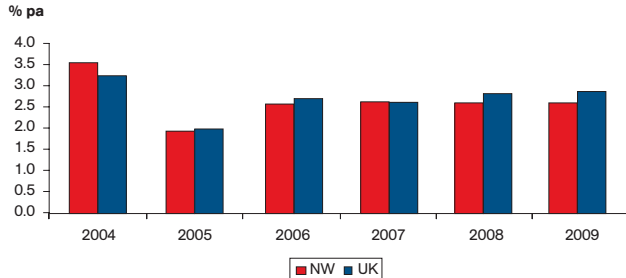
As ever we should be grateful for any comments and suggestions to guide our work. These can be addressed to Nicola.Christie@nwda.co.uk.

David Coates
Panel Chairman
November 2006

Executive Briefing

NORTHWEST OUTLOOK

- We expect the regional economy will grow steadily at 2.6% a year over the next three years. It has shared in what has proved to be a strong recovery from the marked UK consumer-led downturn of 2005. And we still see the next three years as a significant opportunity for business in the Northwest.
- Policy makers are particularly interested in how the regional economy is likely to perform relative to that of the UK as a whole. The chart below shows very strong growth in 2004, especially in the Northwest. We think that this exceptional performance in the Northwest was partly the result of cyclical factors that were still affecting London and the South East more than the rest of the country. But, if our new forecast is correct, the average gap in growth between the region and the UK between 2005 and 2009 will be narrower than in the past, less than 0.2 percentage points a year, perhaps providing some encouraging signs of improvement in its relative performance.



Source: Regional Accounts and Panel Forecasts.

- Stronger Northwest GVA growth in 2006 is expected to come from better prospects in consumer-related services, a return to growth in manufacturing, and stronger growth in financial and business services than in 2005. There are signs that business confidence is recovering among Northwest manufacturers. We expect growth in manufacturing output of over 1% in 2006 to be followed by that a year in between 2007 and 2009.
- Output in consumer related services, such as retailing

and hotels and catering, was hit hard by the slowdown in consumer spending in 2005. Evidence for the first half of 2006 indicates that regional employment in distribution, hotels and catering has been recovering, albeit slowly, and we expect growth in its output to average 2½% a year between 2006 and 2009. However, this is still weak in comparison to rates seen between 2000 and 2004.

- Financial and business services now account for nearly a fifth of the regional economy. The sector saw output growth slow sharply in 2005 from an extraordinary figure of almost 9% in 2004. But, we still expect to see the sector outperforming the regional economy by a substantial margin over the next few years, growing at 4½% in 2006, and then slowing to a more sustainable rate of 3½% a year between 2007 and 2009.
- The public sector has been another recent source of strong growth in the Northwest. With Government spending plans still showing reasonable buoyancy, the sector should continue to grow at a similar rate to the rest of the regional economy to 2009.
- The Northwest labour market weakened in 2005 and into 2006, with a marked fall in employment growth as compared with previous years. Although employment has nevertheless continued to grow, this has been accompanied by an increase in the number of the unemployed. Together with anecdotal evidence, this has led us to assume that the region's workforce has benefited from a proportionate share in recent high levels of net international immigration. Our forecast also assumes that the Northwest will continue to benefit in this way. If this were not so, there would be implications for the strength of its forecast output and employment growth.
- Total employment in the Northwest is expected to rise by 0.3% in 2006 as manufacturing employment continues to fall, and growth in employment in financial and business services slows sharply. Overall employment growth is then expected to pick up in 2007 and 2008 as prospects in financial and business services and in distribution, hotels

and catering improve in particular. Nevertheless, we expect that employment growth in total in the region will be slightly slower than that in the UK over the period to 2009.

WORLD AND UK BACKGROUND

- We accept the consensus view among economic forecasters that world growth will peak in 2006 before slowing a little in 2007, and then remaining steady to 2009. A key point is whether domestic spending in the eurozone recovers enough to outweigh the results for the UK economy of an expected modest slowdown in the US, the main change in the world outlook affecting this forecast. We shall monitor these developments closely.
- The international outlook for commodity prices and input inflation has improved since our last forecast. The price of oil has fallen since August 2006. We expect prices to average \$65 per barrel in 2006, and to fall slightly from this peak level through to 2009.
- Driven by household and Government spending, the recovery in the UK economy in 2006 has been faster than we expected in summer 2006. We now expect UK GDP growth of 2¾% in 2006. After that, we expect UK growth to slow slightly in 2007 because of changes in the composition of expenditure before recovering to 2¾% pa in 2008-09, supported throughout by historically high rates of net international immigration.
- UK manufacturing has experienced a modest recovery during 2006, with stronger growth expected in 2007. Financial and business services continue to grow strongly. They are expected to continue to be a major source of growth, nationally as well as in the region, through to 2009.
- Concern about inflationary pressures in the economy, given the strength of recovery over the past year and uncertainty about the scale of spare capacity in the economy, led the Bank of England to raise the Bank Rate to 5% on 9 November 2006. Although the outlook for

commodity price inflation has weakened, other price pressures have picked up. A further rise in interest rates next year cannot be ruled out.

- Our monitoring will include the extent to which UK household and business investment spending are sustained as world growth and government spending slows, and how net international immigration into the UK develops.

RISKS TO THE FORECAST

- The balance of risks is still on the downside, suggesting that weaker prospects than our central forecast are more likely than stronger ones. The possibility of disruptive geopolitical developments contribute to downside risks, as do worries that growth outside Europe will slow more sharply than we anticipate, and that domestic spending in the eurozone will remain sluggish. Domestically, we have some concerns about the future course of house prices and the strength of consumer confidence if interest rates have yet to peak, and if domestic fuel bills are slow to reflect lower energy prices. On the upside, the prospects of lower energy prices than we have seen recently are consistent with generally lower inflation and with lower interest rates around the world than might otherwise have been expected.

POINTS TO WATCH ABOUT THE NORTHWEST

- When reviewing our business forecasts, we plan to monitor the following regional points in particular
 - Whether an expected improvement in underlying productivity is borne out after evidence of a recent slowdown in its growth
 - If signs of improved performance by Northwest manufacturers are being sustained
 - What happens to skills shortages in the region, and whether these prejudice expected performance
 - How far business is constrained by shortages of certain high level skills

-
- Whether there is evidence of increased representation of higher value-added service activities in the region's financial and business service sector
 - What happens to the Northwest's share of net international immigration, and what effect this has on employment opportunities for those currently on the margins of the labour market.

David Coates
Panel Chairman
November 2006

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The World Economy

KEY POINTS

- Growth in the US and Japan has slowed since April 2006 while growth in the eurozone has accelerated. Business confidence has, however, moderated a little. The consensus view is for world growth to peak in 2006 before slowing a little in 2007 and then remaining little-changed to 2009.
- The dollar weakened in April and sterling and the euro appreciated accordingly. Exchange rates have not changed much since then and are expected to move against the dollar further in 2007, placing further pressure on European exporters.
- The outlook for commodity prices and input inflation has improved with the prices for most major commodities stabilising or, in the case of oil, falling, albeit to levels that remain high.

WORLD GROWTH IS EXPECTED TO PEAK IN 2006

GDP growth in the US has slowed since 2006Q1. The growth in personal consumption has slowed considerably as the housing market has cooled and the labour market has slackened. Business investment has also slowed as sentiment has become more cautious due to concerns over energy prices and inflationary pressures from a weaker dollar. The Federal Reserve did not increase interest rates in July and August, following a sequence of monthly $\frac{1}{4}$ point increases since June 2004, but further rate rises cannot be ruled out. GDP in the US is expected to grow by $3\frac{1}{4}$ - $3\frac{1}{2}$ % in 2006 before slowing to around $2\frac{3}{4}$ -3% in 2007 and beyond, on the assumption that the imbalances reflected in the trade and federal government deficits begin to be corrected.

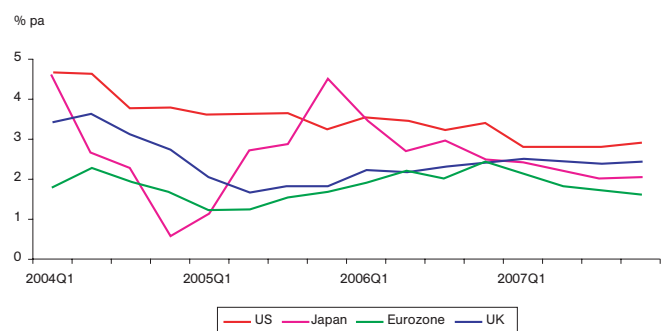
Output growth in Japan slowed in 2006Q2 due to weaker external demand, consistent with weaker UK growth. The growth in private consumption accelerated in 2006Q2, but this has been volatile. The outlook for business investment has strengthened considerably, with growth accelerating in 2006Q2 as company profits and confidence improved.

Meanwhile, the Bank of Japan raised its overnight borrowing rate to $\frac{1}{4}$ % in July as inflation and its expectations strengthened. The consensus is for further increases in interest rates by the end of March 2007. GDP growth of around $2\frac{3}{4}$ % is expected in 2006, slowing to $2\frac{1}{4}$ % in 2007.

In the eurozone there has been a steady improvement in business and consumer confidence during 2006. That being so, consumers remain cautious and inflationary pressures remain a threat. In Germany industrial production has seen steady growth but business confidence has faltered of late due to weak export performance and the implementation of tax increases in 2007. In France there have been recoveries in both domestic and external demand. In the labour market a subsidised jobs programme introduced in 2006 is having some impact but it is unclear how long this government support will last, given the current fiscal deficit.

Overall, the consensus view is that growth in the eurozone will average $2\frac{1}{4}$ % in 2006, but this is not expected to be sustained in 2007 as world growth and export demand slow and interest rates remain on an upward path. Inflation remains above target and since March the European Central Bank (ECB) has raised its refinancing rate from $2\frac{1}{2}$ % to 3%, with the most recent $\frac{1}{4}$ point increase happening in August.

CHART 1: PROSPECTS FOR GROWTH IN THE WORLD ECONOMY



Source: OECD Economic Outlook, Consensus Forecasts (August 2006).

THE WEAKENING OF THE DOLLAR IS EXPECTED TO CONTINUE OVER 2006-08

The dollar weakened in April 2006 reflecting concerns over global political and economic stability, and the size of the US' current account deficit. In response the euro and sterling appreciated. Since May, there has not been much change – the euro has hovered around \$1.27, while sterling has averaged around \$1.87. With inflation above target and growth strengthening in the eurozone, the ECB remains hawkish. By contrast, the Federal Reserve is faced with weakening domestic demand and strong but possibly moderating inflation. Sterling and the euro are expected to average \$1.84 and \$1.25 in 2006 respectively, before strengthening over 2007-09 as the US monetary tightening cycle finishes earlier and on the assumption that a depreciation of the dollar will be required to curb the trade deficit.

COMMODITY PRICES HAVE STOPPED RISING

The outlook for commodities has improved to the extent that most prices appear to have stabilised or are falling. The price of oil was largely unchanged until August 2006 and since then the price of Brent crude has been on a downward trend. In September it fell below \$60 pb for the first time since February as global political tension eased and reported US reserves were healthy. We still expect oil

to average \$65 pb in 2006, and for the price to fall slightly from this peak through to 2009.

With few exceptions the outlook for metal prices has stabilised, although for some – aluminium, copper and zinc – prices remain high by recent standards. It is a similar story for tin, but its trading range has been wider. The price of nickel rose steadily over the summer and only in September was there any sign of it stabilising. Meanwhile, the price of lead has risen by more than 50% from its year low in June and there is no sign of the upward trend coming to a halt. We expect metals and minerals inflation to ease over the coming year as world growth slows down. Inflation for both foodstuffs and agricultural inputs is expected to accelerate over the coming year, but will remain low in comparison.

POINTS TO WATCH

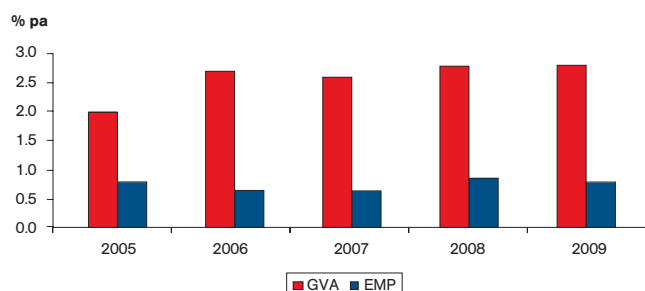
- As the scope for growth driven by domestic demand in the UK is now more limited, the UK economic cycle is likely to be more dependent on growth in world markets. The key item to monitor is whether domestic spending in the eurozone starts to pick up, and does so enough to outweigh the US slowdown. From a UK point of view, this affects the level and direction of demand for our exports.

The UK Economy

KEY POINTS

- The recovery in UK GDP growth has been a little faster than expected and our forecast for 2006 has been upgraded to 2.7%. We expect growth to slow slightly in 2007 as growth in world markets slows but then to pick up slightly in 2008 and 2009. Manufacturing is experiencing a modest recovery during 2006, with stronger growth expected in 2007, while financial and business services continues to grow strongly, and is expected to be the major source of growth through to 2009.
- Consumer price inflation has picked up due largely to rising energy and household costs. The fall in input price inflation may now be being reflected also in output price inflation. Earnings growth has picked up slightly.
- Concern about inflationary pressures in the economy, given the strength of recovery over the past year and uncertainty about the scale of spare capacity in the economy, led the Bank of England to raise the Bank Rate to 5% on 9 November 2006. Although the outlook for commodity price inflation has weakened, other price pressures have picked up. A further rise in interest rates next year cannot be ruled out.
- The key risks on the downside are weaker than expected world growth, and on the upside that energy prices remain lower with a corresponding benefit to inflation.

CHART 2: OUTPUT AND EMPLOYMENT GROWTH PROSPECTS FOR THE UK



Source: Panel Forecasts, November 2006.

THE RECOVERY IN 2006Q1 HAS BEEN SUSTAINED

The recovery seen in 2006Q1 was sustained in 2006Q2 and year-on-year GDP growth is now just above 2½%. Growth in 2006 has been driven by a pick up in government and household spending, and still healthy investment growth. The growth in trade has been strong but the data are inflated by so called 'carousel' fraud (traders obtain VAT registration to acquire goods such as computer components and mobile phones VAT-free from other Member States; they then sell on the goods at VAT inclusive prices and disappear without remitting the VAT to the tax authorities). The net trade position has deteriorated a little in 2006. A sectoral analysis indicates that growth has been driven by a recovery in manufacturing and steady, robust growth in financial and business services. Growth in distribution and transport and communications in the first half of 2006 is an improvement on that a year earlier (2005H1) but is no stronger than in 2005H2. Against this improvement, the level and rate of unemployment have increased although this reflects a substantial increase in the labour supply, both from an increase in the working age population and an increase in activity rates, rather than a fall in demand: seasonally adjusted employment was ½% higher in 2006Q2 than in 2005Q4.

Headline average earnings growth has picked up through 2006, to just under 4½% in July 2006, and household confidence looks to have been boosted with retail sales growth recovering in 2006Q2. Retail sales growth weakened a little over the summer but year-on-year growth is currently running at 4%, compared to 2% in March. Investment growth weakened in 2006Q2 but the outlook remains positive. In the most recent survey by The British Chamber of Commerce (BCC) firms' confidence for turnover and profits was improved, particularly for manufacturing firms. Meanwhile, the Confederation of British Industry's (CBI's) most recent survey indicated no deterioration in firms' investment plans; although neither did it show an upturn. Despite 'carousel' fraud, exporters in the UK have benefited from the recovery in the eurozone. Trade growth has been strong although it did ease a little in 2006Q2 as other major economies started to slow.

GROWTH IS EXPECTED TO BEGIN TO SLOW DOWN IN 2007

We now expect the UK economy to grow by around 2¾% in 2006 and at a slightly slower rate in 2007. We do not expect the slowdown in growth to be prolonged but for growth to recover to around 2¾% in 2008-09, supported by historically high rates of in-migration.

The recent recovery in household spending has been especially strong and this should continue to underpin overall growth in 2006 and 2007. Investment growth eased slightly in 2006Q2, but it is still stronger than in 2005 and this should remain the case for the rest of the year; growth in investment is expected to slow a little in 2007.

Meanwhile, the growth in government spending should ease a little and average 2-2¼% in 2006 and 2007. As domestic spending slows, import growth is expected to weaken in 2007. Similarly, export growth will slow in response to weaker world trade growth in 2007.

Manufacturers have benefited from the pick up in demand. After contracting in 2005, output in the sector is now growing at around ¾% year-on-year. We expect this improvement to carry over into 2007 before weaker growth in world markets limits growth in manufacturing over 2008-09.

Growth in the distribution sector has improved in 2006 as household spending has recovered. The recovery in household spending is expected to be sustained and so the 2006 outturn for distribution should be a significant improvement on that in 2005 before easing slightly in 2007. With prices in the communication services industry continuing to fall and world growth slowing, the growth in value added in the transport and communications sector is set to slow in 2006 and grow at a similar rate in 2007. Financial and business services and public sector services are both expected to see stronger growth in 2006 and so should support the pick-up forecast for 2006. Growth in financial services is likely to slow in 2007 and through to 2009, however, as slower world growth feeds through to international financial markets.

RECENT INFLATION TRENDS HAVE FAVOURED FIRMS

Output price inflation fluctuated between 2½% and 3% year-on-year for the most part in 2006H1, but this rate dropped to 1.8% in September driven by lower petroleum product prices. Input price inflation has slowed from 13-15% year-on-year in early 2006 to 5.1% in September. The recent fall in the price of oil should support this trend over the coming months, easing the pressure on profit margins, although firms that have been sheltered from past increases by forward contracts are now facing higher costs as they negotiate new agreements. Consumer price inflation was just above target in 2006H1, but over the summer it has strengthened to 2½%, with the strongest increases coming in housing costs and recreational expenditure. The recent fall in the price of oil should help contain inflation but stronger earnings growth and consumer spending along with the one-off effect of the sharp increase in university tuition fees are likely to offset this over the coming twelve months.

INTEREST RATES HAVE RISEN AND MIGHT RISE FURTHER

Concerned about the pace of the recovery, the availability of spare capacity, and signs that other pricing pressures have picked up despite a fall back in oil prices, the Bank of England raised its repurchasing (repo) rate to 5% in November 2006. Stronger growth and household spending could increase the likelihood of a further rate rise, while a sustained reduction in the price of oil and slower world growth would work against this. A further rise in interest rates next year cannot be ruled out.

RISKS TO THE UK FORECAST

The economy is now growing at around its trend rate and this looks set to be sustained over 2006-2009. Risks to this are that growth outside Europe and thus export growth, undergoing a sharper slowdown over the coming months, and that domestic spending in the eurozone fails to offset this as much as we have assumed. The impact of tax increases that will be implemented in Germany in early 2007 is also unclear. An additional uncertainty over the

coming months is the strength and duration of weaker household spending in the US and the risk this poses to the global outlook. There is a similar risk from the US trade deficit, where a rebalancing through a stronger depreciation of the dollar could push up global interest rates and lead to slower world growth. However, on a global level, an upside risk would be that the recent reduction in energy prices is sustained, helping to curb inflation and interest rates, and so stimulate activity. Domestically it is not clear how the pick up in the housing market will be affected by the recent increases in interest rates; a sustained slowdown could hamper the recovery in household spending. So, too, would a dent to consumer confidence from further increases in interest rates and the rate of unemployment, or if domestic fuel bills are slow to reflect lower energy prices. Tension

between Iran and the West eased in September while the ceasefire between Israel and Lebanon has held. Nevertheless, geopolitical pressures remain a risk, with the stability of Iraq serving as an example.

POINTS TO WATCH

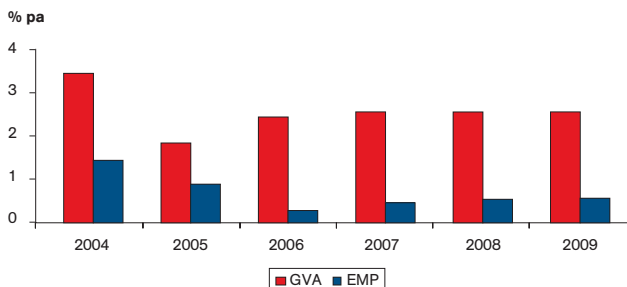
- UK GDP growth prospects in 2007 are particularly sensitive to the extent to which household and business investment spending are sustained, as world growth and government spending slow down.
- They are also sensitive to any slowdown in net immigration, since we estimate that this is currently raising the UK's long-term growth rate by some 0.2 pp or more.

Northwest Economy Outlook

KEY POINTS

- We expect growth in the Northwest economy to strengthen in 2006 after slowing sharply in 2005, and then to strengthen a little further in 2007. Although growth in the Northwest is likely to match that in the UK as a whole in 2007, over the period 2006-2009 we expect that regional growth will be a little slower than in the UK.
- Stronger growth in 2006 is expected to come from better prospects in consumer-related services (including retailing and hotels and catering), a return to growth in manufacturing, and stronger growth in financial and business services.
- There are signs that business confidence is recovering among Northwest manufacturers. We expect manufacturing output to strengthen further in 2007 only for growth to fall back to around 2% pa in 2008 and 2009 following the slowdown in world growth.
- The Northwest labour market weakened in 2005 and into 2006 with employment growth slowing sharply and the number of people unemployed increasing. Employment growth is expected to slow to 1/4-1/2% in 2006 before recovering to average 0.6% pa out to 2009. Financial and business services will continue to be a major source of new jobs through to 2009 while manufacturing employment is expected to continue to fall.

Chart 3: Output and Employment Growth Prospects for the Northwest



Source: Panel Forecasts, November 2006.

OUTPUT GROWTH IS EXPECTED TO PICK UP IN 2006 BUT TO CONTINUE TO UNDERPERFORM THE UK

In 2005, growth in the Northwest economy slowed sharply, as it did in the UK as a whole. Having grown by 3½% in 2004, the economy grew by less than 2% in 2005, reflecting much weaker growth in consumer service sectors, such as retailing and hotels and catering, and falling manufacturing output. When output data is eventually published, we expect that growth in the region in 2005 and 2006 will turn out to have been slightly slower than in the UK as a whole.

Table 1 shows our new forecast for the region and the UK, together with forecasts our consultants made in July for the UK, the Northwest, and some other regions. In July 2006, we took the view that UK growth would peak in 2008 at just over 3%. The Northwest economy was expected to follow a similar path, but to grow a shade slower than the West Midlands, a region with a similar economic structure; and to grow by as much as 1pp a year slower than the London and South East economies.

TABLE 1: REAL GVA GROWTH (% pa)

	2006	2007	2008	2009
CE Forecast as at July 2006				
N.West	2.0	2.4	2.9	2.5
W.Mids	1.8	2.5	3.0	2.7
London	2.9	3.4	3.7	3.1
S.East	2.5	3.1	3.5	3.1
UK	2.2	2.8	3.1	2.8
New Forecast at Nov 2006				
N.West	2.5	2.6	2.6	2.6
UK	2.7	2.6	2.8	2.8

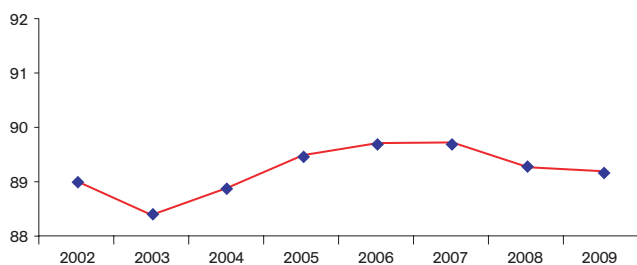
Source(s): Panel Forecasts, November 2006 and Cambridge Econometrics Ltd, July 2006.

In our new forecast, we now expect the UK economy to recover sooner, and for the cycle to peak at a lower rate of growth. In addition, the profile of overall growth in the Northwest economy is expected to differ slightly from that

of the UK as a whole. Although both the UK and the Northwest are expected to see growth accelerate in 2006, the Northwest is likely to see growth strengthen slightly in 2007, before falling back to average just over 2½% pa in 2008 and 2009. In contrast, growth in the UK as a whole is expected to fall back slightly in 2007, and then to recover in 2008 and 2009. These changes will also affect other regions, but the relativities between them should not change all that much.

Generally, growth in the Northwest is still expected to be slightly weaker than in the UK through the forecast period, with the exception of 2007, when an expected quite strong recovery in manufacturing helps lift growth to the UK level of 2.6%. However, since population growth in the Northwest is expected to continue to be weaker than for the UK as a whole, the level of GVA per head generated in the Northwest compared to the UK average is expected to improve slightly in the short term, but then to fall back again in 2008 and 2009.

CHART 4: RELATIVE GVA PER HEAD IN THE NORTHWEST (NOMINAL PRICES, UK=100)



Source: Regional Accounts and Panel Forecasts, November 2006.

Based on the industrial structure of the sub-regional economies, and on the relative historical performance of sectors in different parts of the region, we expect growth in 2006 to be strongest in Greater Manchester and weakest in Lancashire. In the medium and longer term the prospects are most favourable in Cheshire and weakest in Cumbria and Lancashire. Greater Manchester, which generates around 40% of Northwest output (and almost half of that in financial and business services), is expected to perform in

line with the Northwest as a whole. The strength of growth projected for Cheshire reflects the strength of both manufacturing and business services in the economy. The weak prospects for Cumbria, and to some extent Lancashire, reflects the relative importance of agriculture and construction to the economies, where general growth prospects are expected to be weak, and the relatively low representation of stronger performing sectors such as financial and business services. In addition, past experience suggests that the financial and business services firms in these counties are less dynamic than the regional average, and our assumption that this underperformance will continue further restricts the overall performance of these economies.

BUSINESS CONFIDENCE IN MANUFACTURING IS RECOVERING

The regular survey of businesses by The British Chamber of Commerce provides some evidence that confidence is recovering in manufacturing in the region. While confidence in the sector was weak at the end of 2005 and fell further initially in 2006, the 2006Q2 survey reports a sharp increase in the proportion of firms reporting increases in sales and orders both at home and abroad. But this increased confidence is not being reflected in expectations for future employment, with a sizeable balance of companies expecting to reduce employment further in the short term. Despite the improvement in sales and orders, there remains considerable concern about the pressure from the costs of raw materials and business overheads.

TABLE 2: REAL GVA GROWTH WITHIN THE NORTHWEST (% pa)

	2006	2007	2008	2009
Cheshire	2.4	3.0	3.1	3.1
Cumbria	2.3	2.3	2.1	2.3
Greater Manchester	2.7	2.7	2.6	2.6
Lancashire	2.0	2.5	2.3	2.3
Merseyside	2.4	2.6	2.5	2.3
Northwest	2.5	2.6	2.6	2.6

Source(s): Panel Forecasts, November 2006 and Cambridge Econometrics Ltd.

Confidence in the service sector has remained fairly steady in comparison with that in manufacturing, and is generally more optimistic. However, while home orders and sales have generally held up, there is evidence of a dip in firms reporting weaker sales and orders from export markets. Prospects for employment in services remains strong with a balance of around 20% of firms expecting to increase employment in the short term.

MANUFACTURING WILL RETURN TO GROWTH IN 2006, BUT SERVICES ARE KEY TO OVERALL GROWTH

Output growth slowed sharply in 2005 as a result of a sharp slowdown in key private service sectors, including retailing and hotels and catering, and a fall of 1/2% in manufacturing output. The outlook is for overall growth in the Northwest to recover to just over 2% in 2006, with growth in manufacturing output an important factor in this. Although growth is expected to return to the sector in 2006, it will remain weak, at less than 1%. The outlook is for growth to strengthen to over 2% in 2007 in response in part to the further strengthening of key export markets.

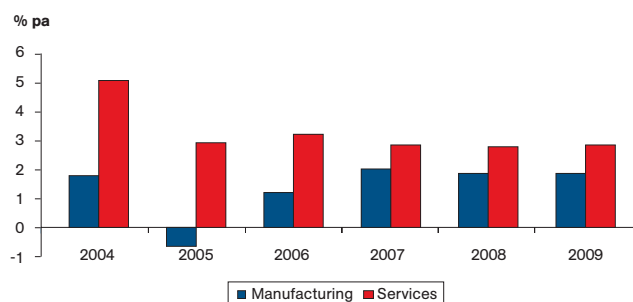
Most consumer-related services, including distribution, retailing, and hotels and catering, are likely to report stronger growth in 2006 than in 2005. However, growth in these sectors is expected to remain below the rates seen in the few years prior to 2005, because a continued recovery in household spending in 2006 will still have

been quite weak. Over 2007-09 growth in distribution, retailing, and hotels and catering is likely to run at around 2 1/4% pa, a slightly slower rate of growth than is expected for consumer spending as a whole.

Financial and business services has been an important pillar of the regional economy in recent years, when exceptional growth was achieved. Although this slowed sharply in 2005, it remained at over 4%, more than twice the rate of growth of the Northwest economy as a whole. We expect the sector to continue to be a key driver of growth for the region through the forecast period, with the immediate prospects for growth strengthening to 4 1/2% in 2006 before falling back to more sustainable rates of around 3 1/2% pa over 2007-09.

Output in public services has benefited from the government commitment to spending on health and education since the late 1990s. This policy commitment is expected to remain in the medium term. The outcome of the forthcoming Comprehensive Spending Review 2007 will have a bearing on government spending towards the end of our forecast. Our working assumption is that while the review may alter the relative priorities for government spending, there will not be scope to alter the expected pattern of a slowdown in spending growth. We expect growth in output for this sector of just under 3% in 2006, slowing to 2 1/2% pa by 2009.

CHART 5: PROSPECTS FOR OUTPUT GROWTH IN THE NORTHWEST



Source: Panel Forecasts, November 2006.

EMPLOYMENT GROWTH WILL REMAIN SLOWER THAN HAS BEEN SEEN IN RECENT YEARS

The Northwest has seen strong employment growth since 2001 at an average rate sufficient to have outpaced that of the UK as a whole. However, employment growth in the region slowed sharply to just over 1/2% in 2005, with strong falls in manufacturing employment and falls also in some service sectors, including hotels and catering, and transport and communications. Overall employment growth is expected to slow slightly in 2006, to just over 1/4%, before recovering to just over 1/2% pa out to 2009.

The slowdown in overall employment growth in 2006 is in response to the expected slowdown in growth in employment in financial and business services. We still expect this sector to be the source of significant new job opportunities, with employment rising by almost 1% during the year, but this is at a much slower rate than has been experienced recently. Elsewhere in the service sector, the prospect is that growth in employment in hotels and catering and transport and communications in 2006 will more than make up for the jobs lost in these sectors in 2005. The outlook is for manufacturing employment to continue to fall by 7,000 in 2006 and a further 10,000 by 2009.

Over the past year the Northwest, like the UK, has experienced a stronger increase in the economically active population than in the number of jobs. The increase in the labour force came partly from a reduction in inactivity, but mainly from a larger adult population, reflecting net immigration into the region. Consequently, unemployment

has risen, but the increase has been larger in the Northwest than in the UK as a whole. In July 2006, claimant count unemployment stood at 3.3% of the workforce, compared with 3% for the UK. We expect the regional unemployment rate to average around 3.3% in both 2006 and 2007 before falling back slightly to 2009 as the economy continues to create a significant number of additional jobs in services as a whole, and in financial and business services and public services in particular.

POINTS TO WATCH

- In the first part of this decade, the Northwest saw rapid employment growth but relatively weak productivity growth. In the forecast, this pattern is not repeated. It will be important to monitor whether this expected change in trend is borne out, and that productivity growth in the region recovers as much as we have assumed, especially relative to the UK.

Northwest and UK GDP 2002 – 2009

TABLE 3: SUMMARY DATA AND FORECASTS FOR THE NORTHWEST

	Units as indicated and % growth pa GVA (£2002m)	Consumer Spending (£2002m)	Unemployment Rate (%)
2002	92,164 1.5	74,208 3.2	3.5 -5.2
2003	94,509 2.5	76,074 2.5	3.2 -6.5
2004	97,802 3.5	78,738 3.5	2.8 -12.2
2005	99,707 1.9	80,006 1.6	2.9 1.1
2006	102,158 2.5	81,446 1.8	3.3 15.1
2007	104,865 2.6	83,399 2.4	3.3 -0.8
2008	107,568 2.6	85,767 2.8	3.2 -3.4
2009	110,319 2.6	87,788 2.4	3.2 -0.6

Source(s): Panel Forecasts, November 2006.

TABLE 4: NORTHWEST AND UK GVA

	Units as indicated and % growth pa NW GVA (£2002m)	UK GVA (£2002m)	Nominal GVA per head (UK=100)
2002	92,164 1.5	910,218 1.7	89 0.0
2003	94,509 2.5	934,336 2.6	88.4 -0.7
2004	97,802 3.5	964,436 3.2	88.9 0.6
2005	99,707 1.9	983,662 2.0	89.5 0.6
2006	102,158 2.5	1,010,221 2.7	89.7 0.2
2007	104,865 2.6	1,036,487 2.6	89.7 0.0
2008	107,568 2.6	1,066,027 2.8	89.3 -0.4
2009	110,319 2.6	1,095,556 2.8	89.2 -0.1

Source(s): Panel Forecasts, November 2006.

Northwest Sector Output

KEY POINTS

- We expect 2006 to show an improvement on 2005, which was a difficult period for the Northwest. Growth of 2½% for the regional economy in 2006 sets the tone for the scene throughout the forecast period, during which we expect a relatively strong performance from manufacturing, along with steady if unspectacular growth in many other sectors of the regional economy, to maintain growth of over 2½% pa to 2009.
- Manufacturing is expected to undergo a period of consolidation, after struggling historically. We expect growth of over 1% in 2006 to be followed by a strong performance between 2007 and 2009 at a rate of 2% pa.
- Transport and communications will benefit from some substantial investment over the next few years. However, we expect this to take several years to be fully reflected in output growth. There will be growth of between 2½-3% over the forecast period, with the suggestion of stronger growth beyond 2009.

MANUFACTURING: There are signs that manufacturing is starting a period of sustained growth

Manufacturing output in the Northwest fell slightly in 2005 after positive, if weak, growth in 2003 and 2004. However, although output fell in 2005, manufacturing in the Northwest continued to outperform the sector in the UK as a whole. Food and drink, and textiles and clothing have continued to perform poorly, and were the major contributory factors to the downturn in output seen in 2005.

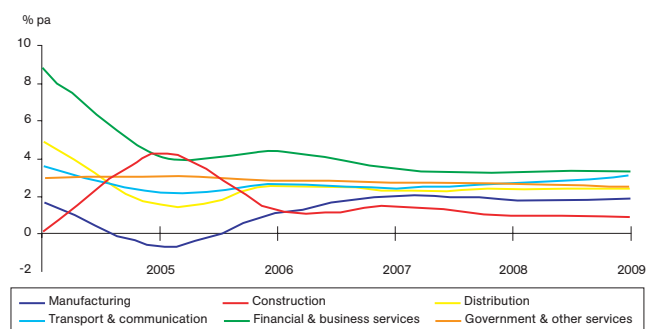
The outlook for 2006 is more optimistic, with recent surveys indicating that manufacturers have seen sales and orders pick up in both home and export markets. We expect output to grow by 1¼% in 2006 and for growth to strengthen to over 2% in 2007 and 2008.

The outlook for motor vehicle production in the region is less optimistic than for other regions. In May 2006 Vauxhall confirmed it was to cut 900 jobs from its Ellesmere Port factory, about a third of the workforce. The company said this reflected ongoing pressure in the industry generally to reduce costs and improve productivity. Doubts remain about the long-term viability of the plant.

Elsewhere in engineering, the outlook is more optimistic, including a much stronger outlook in aerospace. Rolls-Royce has recently opened a new factory in Barnoldswick, Lancashire at a cost of around £7m as part of its continued drive to minimise costs and increase efficiency. BAe Systems is a major presence in the Northwest and the company has recently received a series of boosts to its future prospects. In August 2006, it announced that the government of Saudi Arabia had placed an order for 72 Eurofighter aircraft, a contract that could be worth up to £10bn. On a smaller scale the government's decision to keep submarine-building for the MoD within the UK has improved the prospects for BAe's Barrow-in-Furness shipbuilding operations. However, possible cuts in defence spending have raised doubts over the commissioning of four new submarines which the firm needs to maintain its operations.

Research and development in the region has been boosted by the announcement of two new investments in research and development in the region. AstraZeneca is to invest £60m into Alderley Park, in the latest in a series of major investments by the firm that has transformed the park into the largest research and development facility that the firm owns. The other project involves the NWDA investing £50m in the Daresbury Science and Innovation campus, a move which is expected to create 370 jobs. These developments follow the opening of a new £25m core biotechnology facility at the University of Manchester in June 2006.

CHART 6: NORTHWEST SECTORAL GVA GROWTH



Source: Panel Forecasts, November 2006.

CONSTRUCTION: The strong growth seen in 2005 is not expected to be maintained in 2006 or thereafter

There was strong growth in construction activity in 2005 after weak growth in 2004. Output grew by around 4½% and employment also rose sharply. However, we do not expect such strong growth to be maintained through the forecast. With a number of major developments having been completed recently, we expect output growth to slow to around 1¼% in 2006, picking up to 1½% in 2007 as work in relation to Liverpool being European Capital of Culture in 2008 is completed in time. Generally, however, the relatively weak growth prospects reflect our view that the amount of new work being commissioned is just offsetting completions. In Liverpool alone, it is estimated that developments totalling £250m were completed in the year to August 2006, while construction of the £150m Beetham Tower in Manchester will be completed before the end of 2006.

Among the large new schemes going ahead are the £100m redevelopment of the Sefton Street Quarter in Liverpool and the £220m Inacity Tower in Manchester that is due for completion in 2008.

SERVICES: Services will continue to drive growth in the Northwest

Surveys continue to show services are optimistic about future growth opportunities and employment prospects. We expect this to be reflected in stronger growth in services than in manufacturing over the forecast, but particularly in 2006.

DISTRIBUTION, HOTELS AND CATERING: Growth should strengthen in 2006 but remain below historical levels

The slowdown in consumer spending in 2005 was a major factor behind the sharp slowdown in output growth and the fall in employment experienced by distribution, hotels and catering in 2005. Evidence for the first half of 2006 indicates employment in the sector has increased, albeit slowly. This, together with evidence nationally that growth in consumer spending has not weakened further (and indeed may be strengthening once again), leads us to believe that

output growth in the sector will strengthen in 2006. However, though the anticipated growth of 2¾% will still be weak in comparison to that seen from 2000, this outcome represents a quicker recovery for the sector than we anticipated in our Spring 2006 forecast, even if growth may fall back slightly in 2007 and 2008. The strong growth seen in the past occurred in response to major investment in the region's key retail centres of Manchester and Liverpool in particular. The industry continues to make further investments, including the £900m retail-led regeneration of Liverpool city centre, Liverpool One, which is due to open in 2008. Other smaller developments also have a significant focus on the sector. A new luxury hotel is planned as part of the £27m development of Smithfield, in Manchester's vibrant Northern Quarter, and new hotels are included as part of the Sefton Street scheme in Liverpool.

In Preston, the sector has benefited from the £25m extension to St George's Shopping Centre and the extensive refurbishment of the Fishergate Centre, for which there are also plans for a £37m expansion. The major long-term prospective development for the city is the planned £450m Tithebarn Project which is intended to extend the size and improve the nature of Preston's retail offer and also provide redevelopment opportunities for other uses. A development agreement for the project has been signed and the aim is for completion by 2012.

TRANSPORT AND COMMUNICATIONS: Investments are set to return long-term benefits

Output growth in transport and communications was estimated at over 2% in 2005, and, although this was down on the previous year, we expect growth in the region to rise to 2¾% in 2006 and to increase to around 3¼% in 2009. Considerable investment continues to be made in transport infrastructure in the Northwest, and this will be a factor supporting growth towards the end of the forecast period and beyond. For example, the Department for Transport (DfT) is expected to invest £1.24bn in transport links in the Northwest over the next ten years, involving almost 40 different projects.

Peel Holdings' move to acquire Mersey Docks and Harbour Company, to add to its extensive holdings in the transport industry, is expected to lead to significant investment in all parts of the business. The company has announced plans to invest around £600m in John Lennon Airport, and hopes to develop synergies between operations at the airport and the docks to increase volumes of logistics services and freight handling. We also expect the transport sector in the region to benefit specifically from the activities supporting Liverpool being European Capital of Culture in 2008. It is hoped that the benefits will be more than short-term, with the city benefiting in the longer term from repeat visitors and the effects of having raised its presence in the city-break tourist market.

The communications industry in the Northwest is set to receive a boost with the news that BT is to invest £830m in the region as part of its new 21st Century Network project, to develop a next-generation broadband network. The Northwest will be one of the first areas to receive this technology, and while this is set to boost growth in the communications industry, as well as providing the potential for wider productivity improvement in the Northwest.

FINANCIAL AND BUSINESS SERVICES: Growth set to strengthen in 2006

Financial and business services saw growth slow sharply in 2005 from almost 9% in 2004 after 6% in 2003. However, at 4% the sector continued to outperform the economy as a whole by a substantial margin in 2005. We expect the importance of the sector's overall growth to continue to increase, but for the scale of its growth to slow to a more sustainable rate of 3½% by 2009. While the general trend is expected to be one of slowing growth we do expect growth to pick up slightly in 2006 to 4½% as the sector in the Northwest benefits from its share of the stronger output growth expected nationally.

There has been growth in the banking industry over 2005 and the early part of 2006, including in the private banking

arena (banking services to high net worth individuals). HSBC Private Bank has recently been launched in Manchester, and will compete with Coutts (part of RBS) and Rathbone to attract clients in the region.

The availability of suitable office premises is often cited as an important influence on the prospects for future growth in the sector. While current availability of appropriate space in key areas such as Greater Manchester is limited, the next few years are expected to see significant increases in the availability of such property, which will help to accommodate steady growth. So far, however, the indication has been that firms in the sector in the Northwest tend to be less likely to be engaged in the most innovative of activities, and their markets are more likely to be within the region rather than nationally and internationally, than is the case for its counterpart in London and the Greater South East. At the same time, the sector also has a higher proportion of lower level occupations in its structure of employment, with the consequence that its value added is lower.

GOVERNMENT AND OTHER SERVICES: Growth will remain strong through the forecast

We expect government and other services will also continue to grow over the forecast period. The outcome of the forthcoming Spending Review will have a bearing on government spending towards the end of our forecast. Our working assumption is that while the review may alter the relative priorities for government spending, there will not be scope to alter the expected pattern of a slowdown in spending growth. We expect growth of just under 3% in 2006, slowing to 2½% pa by 2009.

The BBC announced in 2004 that it was intending to transfer 1,800 jobs to the Northwest by 2009. In June of this year, the Corporation announced Salford MediaCity:UK as the preferred site for the relocation. It is hoped that the move will underpin a world class creative and digital business sector in the region by creating facilities for up to 10,000 people.

POINTS TO WATCH

- We shall monitor how well present signs of somewhat stronger manufacturing performance in the Northwest are sustained.
- We shall also look for any evidence of an increased representation of higher value added, more innovative activities in the financial and business services sector, which is becoming ever more important in the structure of the region's economy.

Northwest Sector Output 2002 – 2009

TABLE 5: NORTHWEST SECTOR OUTPUT

£2002m and % growth pa										
	Agriculture	Mining and quarrying	Manufacturing	Electricity, gas and water	Construction	Distribution, hotels and catering	Transport and communications	Financial and business services	Government and other services	Total
2002	727	128	18,778	1,621	5,362	15,392	7,410	16,071	21,819	92,164
	11.3	-2.1	-3.4	-4.8	2.3	4.2	5.9	2.0	2.7	1.5
2003	715	124	18,799	1,491	5,577	15,986	7,721	17,007	22,344	94,509
	-1.7	-3.4	0.1	-8.0	4.0	3.9	4.2	5.8	2.4	2.5
2004	728	129	19,137	1,443	5,586	16,786	8,005	18,496	23,004	97,802
	1.9	4.7	1.8	-3.2	0.2	5.0	3.7	8.8	3.0	3.5
2005	711	132	19,030	1,449	5,825	17,042	8,182	19,268	23,741	99,707
	-2.4	2.3	-0.6	0.4	4.3	1.5	2.2	4.2	3.2	1.9
2006	708	135	19,258	1,478	5,901	17,502	8,403	20,141	24,432	102,158
	-0.4	2.0	1.2	2.0	1.3	2.7	2.7	4.5	2.9	2.5
2007	713	136	19,664	1,493	5,989	17,911	8,613	20,846	25,100	104,865
	0.8	0.7	2.1	1.1	1.5	2.3	2.5	3.5	2.7	2.6
2008	720	136	20,043	1,505	6,051	18,359	8,853	21,549	25,745	107,568
	0.9	0.2	1.9	0.8	1.0	2.5	2.8	3.4	2.6	2.6
2009	728	134	20,427	1,516	6,110	18,818	9,140	22,282	26,377	110,319
	1.2	-1.4	1.9	0.7	1.0	2.5	3.2	3.4	2.5	2.6

Source(s): Panel Forecasts, November 2006.

Northwest Expenditure

KEY POINTS

- We expect the growth in household spending to remain weak in 2006, at 1³/₄%, before recovering to 2¹/₂-3% pa to 2009.
- The saving ratio will remain low, and is not expected to improve through to 2009.
- Investment growth is expected to remain strong, outpacing the growth in the economy as a whole, with both manufacturing and services remaining comparatively optimistic about future investment. Significant investment continues to be made in the region's transport and communications infrastructure.

HOUSEHOLD SPENDING: The weak growth seen in 2005 will continue in 2006

We expect the pattern of growth in household spending in the Northwest to continue to move in line with that for the UK as a whole. The weak growth that occurred in 2005 is expected to persist in 2006, as growth in household incomes is limited by the further slowdown in employment growth. Employment growth is set to pick up in 2007 which, coupled with a slight acceleration in average earnings will raise the growth in household disposable income.

We expect the strength of household spending to rise in line with income growth with little, if any, noticeable change in levels of saving.

FIXED INVESTMENT: Growth will strengthen through the forecast

Data on regional investment are limited, but we consider it likely that investment in the Northwest will rise by 3¹/₂% in 2006, a similar rate to that in 2005. Public sector investment will continue to be an important factor supporting growth, as will that from a strong financial and business services sector. Manufacturing investment is expected to improve in 2006 but the scale of the improvement will be limited by the continued weak output growth that is expected.

It is expected that investment growth will improve still further through the forecast, with growth rates of around 4-4¹/₄% expected over 2007 and 2008. One factor supporting this stronger investment growth will be stronger manufacturing investment, which can be expected alongside the improved output prospects.

Investment in transport and communications infrastructure will continue to benefit the region in the short and long term. In addition to the substantial investments by the Department for Transport (DfT), Peel Holdings and British Telecom referred to in the previous section, the local transport network in Manchester is to be further upgraded with the £650m expansion of the Metrolink network.

Components of Northwest Expenditure 2002 – 2009

TABLE 6: NORTHWEST EXPENDITURE

£2002m and % growth pa					
	Household Expenditure	Government Consumption	Investment	Exports	Imports
2002	74,208 3.2	21,169 3.9	15,692 1.5	72,108 -1.1	81,148 0.7
2003	76,074 2.5	21,972 3.8	15,922 1.5	73,086 1.4	81,37 0.3
2004	78,738 3.5	22,537 2.6	16,755 5.2	75,205 2.9	84,05 3.3
2005	80,006 1.6	23,260 3.2	17,381 3.7	160,927 114.0	86,158 2.5
2006	81,446 1.8	23,978 3.1	18,013 3.6	162,697 1.1	88,226 2.4
2007	83,399 2.4	24,678 2.9	18,750 4.1	168,247 3.4	89,816 1.8
2008	85,767 2.8	25,391 2.9	19,461 3.8	173,314 3.0	90,983 1.3
2009	87,788 2.4	26,039 2.6	20,125 3.4	178,806 3.2	92,180 1.3

Source(s): Panel Forecasts, November 2006.

TABLE 7: NORTHWEST HOUSEHOLD INCOME AND SPENDING

Units as indicated and % growth pa						
	Household Disposable Income (£m)	Household Spending (£m)	Saving (£m)	Saving Ratio (% of disp. income)	Household Disposable Income (£2002m)	Household Spending (£2002m)
2002	74,138 2.9	74,208 4.7	-70 -105.9	-0.1 -105.8	74,138 1.4	74,208 3.2
2003	77,564 4.6	77,566 4.5	-2 -96.9	0.0 -97.0	76,072 2.6	76,074 2.5
2004	80,369 3.6	81,380 4.9	-1,011 46,186.9	-1.3 44571.5	77,760 2.2	78,73 3.5
2005	83,670 4.1	84,334 3.6	-664 -34.3	-0.8 -36.9	79,376 2.1	80,00 1.6
2006	87,100 4.1	87,660 3.9	-560 -15.7	-0.6 -19.0	80,926 2.0	81,446 1.8
2007	91,298 4.8	91,705 4.6	-407 -27.4	-0.4 -30.7	83,029 2.6	83,399 2.4
2008	95,894 5.0	96,480 5.2	-586 44.2	-0.6 37.3	85,246 2.7	85,767 2.8
2009	100,509 4.8	100,921 4.6	-412 -29.6	-0.4 -32.9	87,430 2.6	87,788 2.4

Source(s): Panel Forecasts, November 2006.

Northwest Labour Markets

KEY POINTS

- Employment in the Northwest is expected to increase by only 0.3% in 2006, as manufacturing employment continues to fall and growth in employment in financial and business services slows sharply.
- Employment growth is expected to improve in 2007 and 2008, with a slower rate of decline in manufacturing jobs, and a recovery in employment growth in financial and business services. An additional 22,000 jobs are expected in financial and business services by 2009. And while employment growth in the Northwest is expected to lag behind that for the UK as a whole, the gap between these rates is expected to be small.
- Unemployment in the Northwest has risen more sharply than in the UK as a whole during the first half of 2006, particularly among males. As employment growth picks up in 2007 unemployment in the region is expected to respond, though the unemployment rate is likely to remain above 3% of the workforce.

EMPLOYMENT: Estimates for Northwest employment have been revised downwards

Data published by the ONS in Labour Market Trends, October 2006 show a significant downward revision in the estimates of employment in the region at the end of 2005. The revisions are most marked in construction, transport and communications and health and social work, and among full-time employees, particularly males. There was a smaller upward revision in the estimate of part-time female jobs.

Estimates of employment for the first half of 2006 show that the slow growth in employment continued, and despite the growth the number of employee jobs in June 2006 was actually lower than a year earlier. Overall, employment growth in the Northwest in 2006 is expected to be 0.3%, noticeably slower growth than is likely for the UK as a whole.

Employment growth in the Northwest is expected to pick up in 2007 as strong growth in manufacturing output slows the loss of jobs in that sector. Employment is also expected

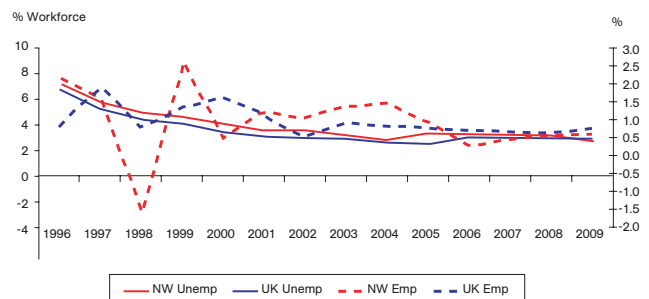
to strengthen in financial and business services and government services while employment in distribution, hotels and catering will strengthen after two years in which employment either fell or was very weak.

It is a working assumption in this forecast that the Northwest economy has been sharing in the growth in the active workforce nationally that has come through net international immigration, especially of late from Eastern Europe. It will be some time before we have data that can throw light on the accuracy of this assumption, but there is a widespread impression of the strength of the contribution this group is making to the regional economy, not just in filling jobs, but in the work ethic many display, which also has a bearing on productivity. Our forecast assumes that the Northwest continues to benefit in this way. If it did not do so, then there would be implications for the future strength of employment and output growth in the region.

UNEMPLOYMENT: Unemployment has been rising but is expected to fall from 2007

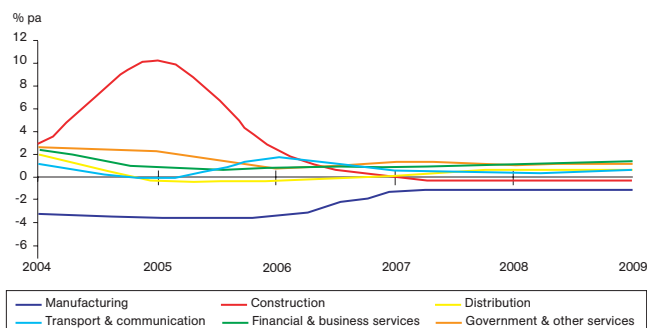
During 2006, unemployment in the Northwest has been rising at a pace faster than in the UK as a whole. In July 2006, claimant count unemployment stood at 3.3% of the workforce compared with 3% for the UK as a whole. According to figures for the ILO definition of unemployment the increase has been at an even faster pace. Our view is that unemployment will peak in 2006 and start a slow decline in 2007 that will continue through the forecast.

CHART 7: RECENT DEVELOPMENTS IN THE LABOUR MARKET



Source: Panel Forecasts, November 2006.

CHART 8: NORTHWEST SECTORAL EMPLOYMENT GROWTH



Source: Panel Forecasts, November 2006.

SKILLS: a number of potentially important constraints

We are concerned as a Panel by the difficulties several of our members are reporting in recruiting especially experienced skills in engineering and some sciences, management for construction projects, and high quality individuals for more senior posts in financial and business services. There is no doubt that some of these shortages are national, but there is sufficient experience of the difficulty of attracting experienced staff to the region, especially those who do not have roots in the Northwest, for this to be a matter of concern. Its effect could be to hold back the long-term growth potential of the regional economy.

More generally, the results of the National Employers Skills Survey for 2005 are also concerning, since they show that the Northwest had proportionately the largest number of skill shortage vacancies, hard-to-fill vacancies, and overall vacancies among the English regions. This may not be too surprising given the relatively sharp growth in employment in recent years, but the evidence does suggest that the region may have drawn down heavily on its reserves of inactive people who are able and prepared to work. The skills shortage finding is also significant in that it refers to those in jobs who lack the skills to do them as well as they might. This presents a considerable challenge to employers, and to those in training on whom they might draw, since improvement in these skills is crucial if productivity growth in the region is to be recovered.

The strength of our forecast assumes that these difficulties will generally be overcome, helped especially at the lower end by continued net international immigration. However, it is in the area of skills that we have the greatest concerns for our forecast, making the following points we plan to watch especially important:

POINTS TO WATCH

- What is happening to vacancies, and hard-to-fill vacancies, in particular. More generally, what is the position regarding participation in the labour force
- What is happening to reported skill shortage vacancies, because of the bearing we think these may have on the recovery of productivity growth in the region
- Whether employers are able to find ways of meeting specific higher level skills constraints, especially in engineering, some sciences, and the management of construction projects
- Whether or not employers, especially in financial and business services, report that they are finding it easier to retain and attract especially able individuals from other parts of the UK
- What is happening to the Northwest's share of net international immigration, and what effect this is having on employment opportunities for those currently on the margins of the labour markets?

Northwest Labour Markets 2002 – 2009

TABLE 8: NORTHWEST LABOUR MARKET

Units as indicated and % growth pa					
	Employees in Employment (000s)	Employment (000s)	Unemployment (000s)	Unemployment rate (% NW)	Unemployment rate (% UK)
2002	2,931 1.4	3,277 1.1	118 -4.4	3.5 -5.2	3.1 -2.8
2003	2,957 0.9	3,323 1.4	112 -5.4	3.2 -6.5	3.0 -2.3
2004	2,988 1.1	3,373 1.5	99 -11.2	2.8 -12.2	2.7 -9.1
2005	3,037 1.6	3,404 0.9	101 2.0	2.9 1.1	2.7 0.2
2006	3,050 0.5	3,413 0.3	117 16.0	3.3 15.1	3.0 11.4
2007	3,074 0.8	3,431 0.5	117 -0.3	3.3 -0.8	3.1 0.8
2008	3,100 0.9	3,452 0.6	114 -2.9	3.2 -3.4	3.0 -3.4
2009	3,125 0.8	3,472 0.6	114 -0.1	3.2 -0.6	2.9 -0.6

Source(s): Panel Forecasts, November 2006.

Northwest Sector Employment 2002 – 2009

TABLE 9: NORTHWEST SECTOR EMPLOYMENT

000's and % growth pa										
	Agriculture	Mining and quarrying	Manufacturing	Electricity, gas and water	Construction	Distribution, hotels and catering	Transport and communications	Financial and business services	Government and other services	Total
2002	23 -10.3	3 -22.5	480 -5.2	15 -20.3	197 0.3	776 0.8	209 3.7	549 5.5	1,026 2.5	3,277 1.1
2003	24 4.5	2 -10.2	465 -3.2	10 -32.9	200 1.7	787 1.4	212 1.7	576 4.9	1,048 2.1	3,323 1.4
2004	23 -4.8	2 -10.2	451 -3.1	8 -21.7	206 2.8	803 2.1	215 1.3	590 2.5	1,077 2.8	3,373 1.5
2005	21 -9.5	2 3.7	435 -3.4	8 0.5	227 10.4	801 -0.2	215 0.0	595 0.9	1,100 2.2	3,404 0.9
2006	20 -1.8	2 -5.5	421 -3.4	8 1.3	233 2.4	801 -0.1	219 1.7	600 0.9	1,111 1.0	3,413 0.3
2007	20 -3.3	2 -0.7	415 -1.3	8 -3.3	233 0.0	803 0.3	220 0.6	606 1.0	1,126 1.4	3,431 0.5
2008	19 -2.7	2 0.1	410 -1.2	7 -3.4	232 -0.3	809 0.8	221 0.4	614 1.3	1,138 1.1	3,452 0.6
2009	19 -2.3	2 -0.9	405 -1.2	7 -3.0	231 -0.3	814 0.6	222 0.8	622 1.4	1,149 1.0	3,472 0.6

Source(s): Panel Forecasts, November 2006.

Northwest Prices and Earnings

KEY POINTS

- Inflationary pressures continue as uncertainty in oil markets impacts on agents' expectations and producers try to pass on to consumers increases in input prices, although global competition from manufacturers based in the low-cost economies of Eastern Europe and China, clearly place a constraint on the scope for such price increases.
- The growth in average earnings is expected to accelerate slightly over 2007 and 2008 as employment growth picks up, but should ease thereafter.

PRICES AND INFLATION: Price inflation is picking up again

The recent movements in consumer price inflation have been erratic. In September 2005, CPI was peaking at 2½%, yet by March 2006 it had fallen below the Monetary Policy Committee's target of 2% due to a temporary reduction in petrol prices relative to the previous months and lower year-on-year food price inflation. However, in April 2006 the price of crude oil rose to around \$70 pb, and this in turn caused the CPI to rise back to 2.0% as a result of the increased cost of petrol and oil-related products. Further increases in inflation are possible because of the impact such increases have on purchasers.

Input prices have risen almost every month since July 2004, and for the year to April 2006 input prices were up by 15.7% with a monthly increase of 2.5% between March and April. The recent cost increase has mainly been due to a 10.6% increase in crude oil prices, and increases in the price of imported metals. The price of oil and imported metals have contributed to much of the historical increase in input prices, but increasing gas prices and the cost of basic metals have also had an important impact.

The constant increase of input prices has put severe pressure on manufacturers' margins, who have not always found it easy to pass on such costs to customers. However, it now appears that manufacturers are having more success at passing on their higher costs as output inflation was running in the range 2¾-3% in 2006Q1. It is

also possible that after such a prolonged period of increasing input prices, manufacturers have been less able to make cost cuts elsewhere (for example, in the wage bill) and have had little option but to pass on cost increases to consumers. However, global competition with foreign manufacturers based in the low-cost economies of Eastern Europe and China, clearly place a constraint on the scope for price increases. The regular survey of businesses by The British Chamber of Commerce continues to report the majority of manufacturers in particular continue to be concerned over the price of raw materials. Specifically, at the end of 2005 output prices hardly changed while input prices continued to increase by 1-2% per month.

EARNINGS: The impact on wage inflation of the expectations of higher price inflation is likely to be offset by weaker demand for labour in the short term

In the second half of 2005, the growth in average earnings slowed from a headline rate of 4.2% to about 3.5%. This slowdown in earnings inflation was a reflection of the slowdown in growth of the wider economy. However, during 2006 earnings growth has risen, to 4.2% in March 2006 and 4.3% in June 2006. The increase in wage inflation has been concentrated mainly in the private sector and reflects the strength of bonus payments: average earnings inflation excluding bonuses has remained steady through 2006H1 at 3.8%.

We think it likely that the growth in average earnings will pick up in line with the current trend of CPI inflation. The Bank of England's recent Inflation Attitudes report found that in general people expect inflation to increase over the remainder of 2006 and at a rate above the Monetary Policy Committee's 2% target. Therefore, it appears that people have responded to the recent increases in crude oil prices and gas prices by adjusting their expectation of future inflation upwards. However, the labour market has weakened, with employment growth slowing, unemployment increasing over 2006H1 and the number of vacancies falling. These factors will mitigate the upward pressure on earnings in the short term.

Northwest Prices and Earnings 2002 – 2009

TABLE 10: NORTHWEST PRICES AND COSTS

Units as indicted and % <i>growth</i> pa					
	Average Earnings (NW) (£s)	Average Earnings (UK) (£s)	Retail Price Index (RPI) (1987=100)	Retail Price Index excl. Mortgage Interest Payments (RPIX) (1987=100)	Pace of Consumer Expenditure (NW) (2002=100)
2002	18,736 3.8	19,375 3.6	176.2 1.6	175.1 2.2	100.0 1.4
2003	19,384 3.5	19,984 3.1	181.3 2.9	180.0 2.8	101.8 1.8
2004	20,069 3.5	20,737 3.8	186.7 3.0	184.0 2.2	103.0 1.2
2005	20,875 4.0	21,647 4.4	192.0 2.8	188.2 2.3	104.7 1.7
2006	21,727 4.1	22,556 4.2	196.3 2.3	192.1 2.1	106.6 1.8
2007	22,663 4.3	23,546 4.4	201.2 2.5	196.0 2.0	108.7 2.0
2008	23,671 4.4	24,619 4.6	206.4 2.6	200.2 2.2	111.0 2.1
2009	24,704 4.4	25,724 4.5	211.0 2.2	204.5 2.2	113.3 2.1

Source(s): Panel Forecasts, November 2006.

Northwest Construction and Housing

KEY POINTS

- The value of construction output increased by 6½% in 2006H1, due primarily to a large increase in housing-related work. The value of infrastructure work fell.
- Although the housing market remains weak, there are signs that activity is increasing. This could lead to further upward pressure on prices.

CONSTRUCTION ORDERS: The value of orders has risen in 2006H1

Construction orders have increased through the first half of 2006, with those relating to house building significantly above their 2005 levels. However, the level of infrastructure orders placed has gone down substantially, along with other public sector orders. While the level of private industrial orders has remained relatively stable through 2005 and 2006H1, there has been a large increase in the value of orders for private commercial work.

The overall value of construction activity in 2006H1 was 6½% higher year-on-year, which was again due primarily to housing-related work.

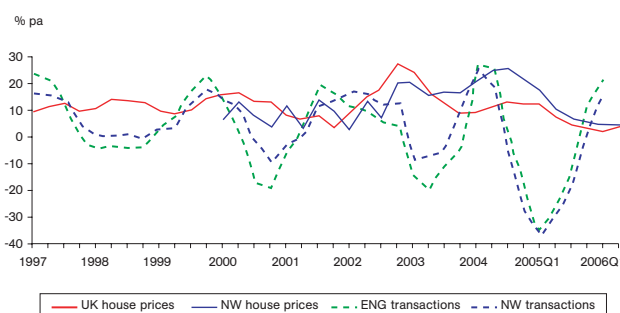
HOUSE PRICES: The market is starting to show signs of recovery

The Northwest housing market has continued to track that for the UK as a whole. House price inflation continued to slow through 2005 and 2006H1 as interest rates crept upwards. In 2006Q2, prices were on average just 3¾% higher than a year earlier. The slowdown in price inflation was accompanied by a sharp fall in the number of transactions in the market. However, recently there has been a recovery in the level of activity in the market, both in the Northwest and in the UK as a whole. Although activity remains a long way below the levels seen at the peak in 2004, it is likely that the strengthening will begin to put upward pressure on prices towards the end of 2006 and into 2007.

HOUSING INVESTMENT: Prospects for private and public housing investment continue to be good

The prospects for housing investment in the Northwest remain favourable in both the short and long term. Housing starts rose strongly in 2006Q1, by more than 30% year-on-year. Growth in public housing starts and refurbishments were part of this. The outlook is for further growth in public sector housing investment in the short term. The newly created Parkway Green Housing Trust is another example of public investment to improve homes in the Northwest. The Trust will spend about £90m over the next six years to meet the government's decent homes standards in Parkway Green neighbourhoods in Manchester. In April 2006 Newheartlands in Merseyside also received a further £110m (in addition to the £86m announced in 2004) from the Housing Market Renewal Fund to improve housing stock over the next two years up to 2008. There are similar investments being made elsewhere in the region. The government is making up to £106m available to the Manchester/Salford Housing Market Renewal Pathfinder over 2006-08 while ELEVATE, the Pathfinder for East Lancashire, recently secured a £16.3m grant from the Housing Corporation for 2006-08 to increase the supply of affordable homes.

CHART 9: RECENT DEVELOPMENTS IN THE HOUSING MARKET



Source: ODPM.



