



# Regional Economic Forecasting Panel

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## Business Forecasts Northwest

A Short Term Forecast for 2007–10

Spring 2007

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Produced by The Regional Economic Forecasting Panel on behalf of the

**Regional Intelligence Unit.** [www.nwriu.co.uk](http://www.nwriu.co.uk)



INVESTING IN  
englandsnorthwest

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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**

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# Foreword

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The strength of recovery this year and last from the marked consumer-led downturn of 2005 has led to inflationary pressures which the Bank of England has been obliged to meet with interest rate increases that still have further to go. Coupled with a somewhat less helpful world economic background, our new forecast therefore shows a slightly less buoyant picture for growth in the Northwest over the next few years than its predecessor published last November. However, the difference is slight, and we still see significant opportunities for business in the region, now in a period up to and including 2010.

Growth in prospect in the Northwest is still a good deal faster than was seen on average through the 1990s, and is also faster than the region achieved on average in the first five years of this decade. And if our new forecast has the UK pulling away from the Northwest a little faster than we thought last time, the reason has to do with the continued strength of the increasingly important financial and business services sector, especially in London, where some slowing in the growth of activity is anticipated, but which still is expected to outpace growth in this sector in the Northwest.

We have again provided an Executive Briefing designed to be free standing so that readers can treat it as summary and introduction to our forecasts, or download it from [www.nwriu.co.uk](http://www.nwriu.co.uk) to forward it to colleagues and others to give them the essence of our views.

In this edition we have included a set of charts in the Executive Briefing that show our GVA forecasts for the Northwest and for the UK as a whole, and for all the major sectors we discuss in developing our forecasts. We as a Panel find such charts a very clear way of setting out what we think is likely to happen, and trust you will find them helpful too. [The charts also appear in the text in the Chapter of the full report on Northwest Sector Output, where our thinking about the reasons for the paths they show is set out.]

Our other publications can also be found at [www.nwriu.co.uk](http://www.nwriu.co.uk), including our revised Long Term report on prospects for the regional economy over the next twenty years, which concentrates on the factors that we believe will influence its development relative to the UK as whole. We pay particular attention in that report to influences on the gap in GVA per head between the region and the UK, and on the relative performance of financial and business services. Thinking developed in preparing that report has also had an important influence on our approach to developments in the next few years as well.

While the Panel is independent of NWDA, we enjoy the support of the region's Research 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 Cambridge Econometrics supported by SQW Consulting for draft material we have taken 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](mailto:Nicola.Christie@nwda.co.uk)

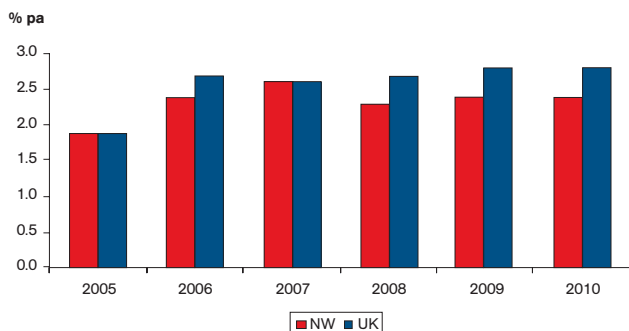
David Coates  
Panel Chairman  
June 2007

# Executive Briefing

## NORTHWEST OUTLOOK

- The Northwest economy is forecast to grow by 2.6% in 2007, slightly faster than in 2006. And after this two year recovery period from the sharp downturn in 2005, we expect GVA in the region to grow at 2.3% in 2008, and at 2.4% in 2009 and 2010.
- Although the Northwest is expected to achieve significantly higher rates of growth than in the 1990s, when its average rate of growth was 1.8% a year, and somewhat faster growth than in the period 2000-2005, when the average was 2.2%, we do not expect its economy to grow quite as quickly as the UK in the period to 2010.
- As the chart below shows, we expect a gap in growth rates of 0.4 percentage points a year between the Northwest and the UK as from 2008. Much of this is a result of national prospects for financial & business services nationally, greatly influenced by the strength and characteristics of the sector in London where it now contributes a half of the capital's GVA as compared with 28% nationally and 20% in the Northwest, and where there is a particular concentration of top end activity.

### GVA growth in the Northwest and UK



Source: Regional Accounts and Panel Forecasts.

- Stronger Northwest GVA growth in 2007 is expected to come from construction, transport & communications and public services. These gains are expected to outweigh an anticipated slowdown in growth in manufacturing, in distribution hotels & catering, and in financial & business

services. We foresee growth slowing again in several sectors in the region in 2008 to produce 2.3% for the region as a whole followed by 2.4% in 2009 and 2010. This reflects forecast sectoral changes in the region and in the UK summarised in the charts behind this briefing

- Although recent growth in manufacturing has been weak, the sector in the Northwest has done better than its national counterpart. We expect its growth to slow to 1<sup>1</sup>/<sub>4</sub>% in 2007 and 2008, restricted in part by the anticipated slowdown in the world economy, before strengthening over the remainder of the forecast. However, growth is still expected to remain below 2% pa.
- Financial & business services will still remain a key driver of growth in the region. Growth of 5-8% pa has been achieved in the Northwest since 2003, but this is expected to slow to below 5% in 2007, to 3% in 2008 and a shade higher in 2009 and 2010.
- Growth in consumer-related services, such as retailing and hotels & catering, recovered strongly in 2006 following the hit this sector took in 2005 because of the slowdown in consumer spending. We believe its immediate prospects are for its growth to weaken to 2<sup>1</sup>/<sub>2</sub>% pa in 2007 and 2<sup>1</sup>/<sub>4</sub>% in 2008 in line with expected changes in the growth in household spending.
- We expect government and other services will grow by 2% in 2007, a faster rate of growth than is expected in the UK as a whole, lifting the region's growth to par with the UK, and then to average just over 2-2<sup>1</sup>/<sub>4</sub>% pa in the period to 2010. However, the outcome of the forthcoming Comprehensive Spending Review will greatly influence the rate of growth that can be expected towards the end of our forecast period, and there are also concerns about the effect of the Olympics on the balance of spend across the regions.
- The Northwest labour market has weakened sharply, with employment growth slowing from just less than 1% in 2005 to a little over 1/4% in 2006. The growth in

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employment in financial & business services in particular was much slower. Employment growth in total in the region is expected to strengthen to 0.6% in 2007. However, employment prospects within financial & business services are likely to remain subdued, and employment in distribution, hotels & catering is expected to fall further, albeit at a slower rate than the 1/2% fall seen in 2006. In the longer term total employment growth is expected to average about 1/2% pa, with the strongest growth in jobs still occurring in financial & business services.

#### 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 that, of the major economies, only the US is likely to see an appreciable pick-up in growth over 2007-10. This is a slightly less buoyant outlook than was reflected in our last forecast in this series.
- Interest rates in the US and the euro-zone are expected to start falling later in 2007, although less rapidly in the zone. The dollar is expected to continue to depreciate against the euro and against sterling, while the euro is expected to strengthen against sterling over 2007-10.
- If geopolitical tension does not increase, we expect that oil prices will fall back a little from recent highs. Inflationary pressures in other commodity prices are expected to weaken a little in 2007 in response to slower world growth. Thereafter, commodity prices are likely to ease as increases in capacity come through against a background of somewhat slower world economic growth.
- UK growth is expected to dip slightly in 2007 before accelerating a little thereafter. Household spending is forecast to continue to grow, but not rapidly, while business investment is expected to remain robust. Consequently, at 2.7%, UK GDP growth is forecast to be only slightly lower in 2007 than in 2006.

- Despite five increases in interest rates since August 2006, inflation remains strong in comparison to recent years. The pick-up in headline average earnings inflation and manufacturers' price inflation in 2007 have made a further increase in interest rates likely during the second half of 2007.

#### RISKS TO THE FORECAST

- The balance of risks remains on the downside. International risks continue to include the possibility of disruptive geopolitical developments affecting oil prices. Also a key question affecting next year remains whether the recovery in demand in the euro-zone will strengthen and offset the current US slowdown. If not, there will be a knock-on effect on demand for UK exports. And further ahead it matters whether EU trading partners can develop sufficient political will to push through much needed business and labour reforms in the euro-zone.
- Domestically, we see the key risk is that inflation may stay strong, forcing the Bank of England to impose a higher path in interest rates than we have assumed. This would lead to a further strengthening of sterling, making conditions even harder for exporters. At the same time, higher interest rates would curb investment demand and household spending.

#### POINTS TO WATCH ABOUT THE NORTHWEST

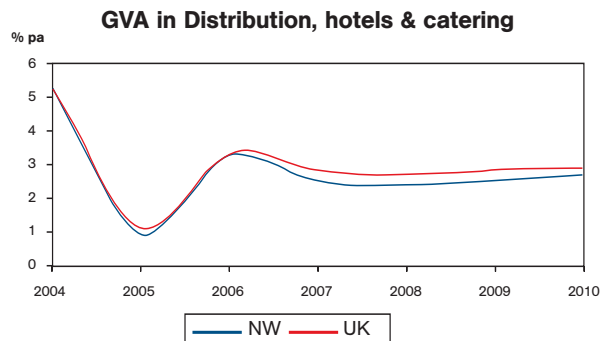
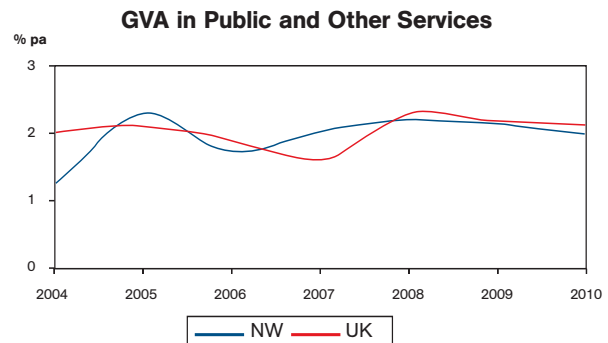
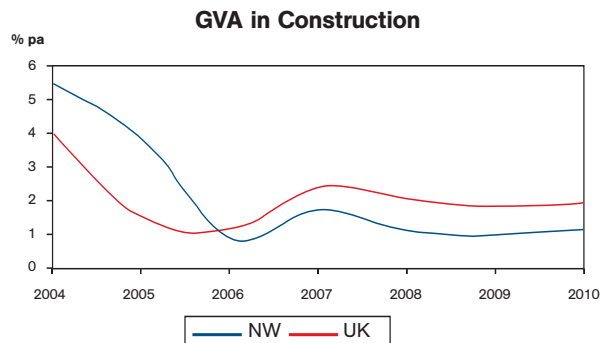
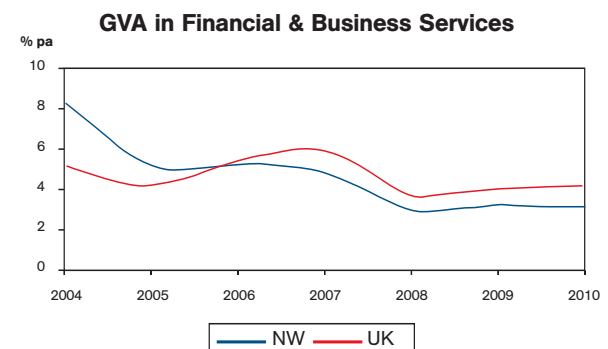
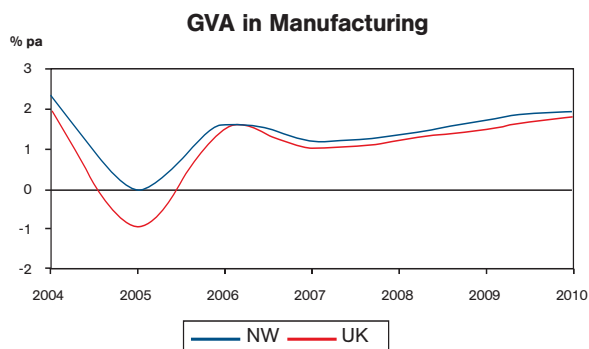
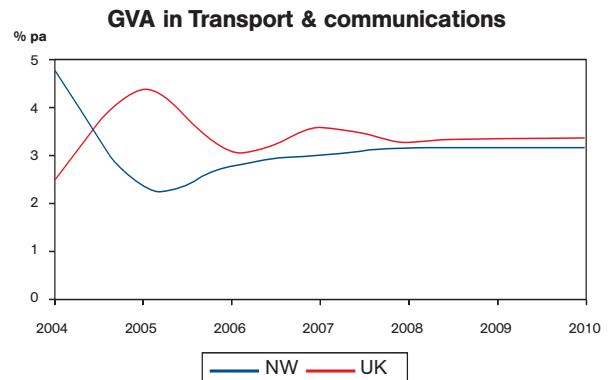
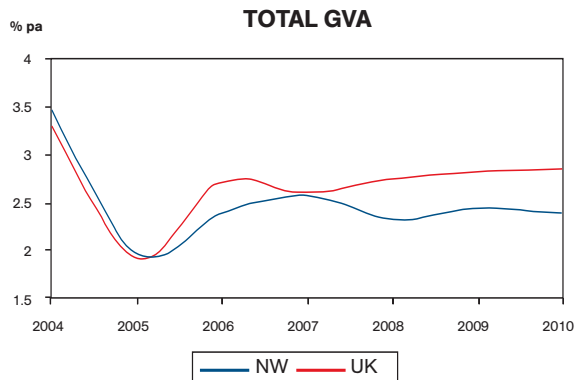
- Particular points we shall monitor when reviewing our short-term business forecasts include:
  - Whether the representation of higher value-added activities in financial & business services increases in the region, and what happens to the growth of back-office and supporting functions that have made a big contribution in recent years.

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- Whether productivity growth in public services increases from the poor outcomes achieved in recent years, what is the outcome of the government's spending review, and whether the Olympics does seem likely to have a diversionary effect on public spending.
  - Whether there is further evidence that the increase in women's participation, which has contributed a lot to recent employment growth, is coming to an end.
  - The trend in skills shortages and skills gaps throughout the region.
  - What happens to the Northwest's share of net international immigration, and what effect this has on employment opportunities for those currently on the margin of the labour force.

David Coates  
Panel Chairman  
June 2007

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# Sectoral Growth Charts



**WEIGHT OF KEY SECTORS IN OVERALL GVA**  
(% of total, 2005)

	Northwest	UK
Manufacturing	18.6	14.4
Construction	6.4	6.2
Distribution, hotels & catering	16.5	15.8
Transport & communications	8.2	8.0
Financial & Business services	20.2	26.6
Public and other services	23.5	23.6

Source(s): Cambridge Econometrics.



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# The World Economy

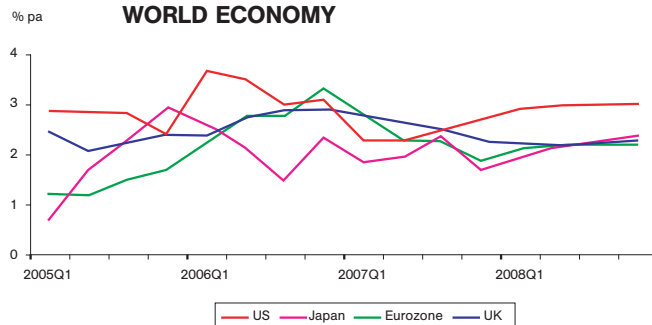
## KEY POINTS

- None of the major economies is expected to see faster growth in 2007 than was achieved in 2006, and only the US is expected to see an appreciable pick-up over 2007-10.
- Interest rates in the US and the euro-zone are expected to start falling later in 2007, although less rapidly in the zone.
- The dollar is expected to continue to depreciate against the euro and against sterling into 2008, while the euro is expected to strengthen against sterling between 2007 and 2010.
- Oil prices are expected to fall back somewhat over 2007-10, and inflation in other commodity prices is also expected to slow.

## WORLD GROWTH IS EXPECTED TO SLOW DOWN IN 2007

In our Autumn 2006 short term forecast, we said that a key issue to monitor would be whether domestic spending in the euro-zone would start to pick up and, if so, whether this would be sufficient to outweigh an expected slowdown in the US. Although recent data indicate the recovery in the euro-zone has been broadly based, the pick-up in the growth of domestic spending has, if anything, eased a little. In the US, business investment has been weak since the end of 2006, but consumer spending has been more resilient than expected.

**CHART 1: PROSPECTS FOR GROWTH IN THE WORLD ECONOMY**



Source: OECD Economic Outlook, Consensus Forecasts (April 2007).

Growth in the US has started to slow down as house prices, household spending, and investment have all cooled. At the same time, the dampening of activity and some moderation of energy prices have both helped to ease consumer price inflation. The recent renewed upturn in oil prices and the weakness of the dollar will put upward pressure on prices, which we expect will be countered by tight monetary policy, at least in the first half of the year.

In Japan, sustained growth in China has supported exports. Growth is expected to continue at about the same rate in 2007 as in 2006, at around 2%, with higher employment helping to reduce joblessness, and inflation expected to moderate in response to weaker commodity price inflation.

Looking further ahead, US growth should recover after the slowdown in 2007. In Japan, growth is currently at a sustainable rate, and so the slowdown expected over 2007-10 should be slight. In the euro-zone, assuming the pace of reform does not accelerate, growth is also expected to slow a little over 2007-10.

Improving trade conditions for the euro-zone have boosted Germany's manufacturing and export sectors, although manufacturers in France and Italy have not benefited as much. So far into 2007, industrial activity and confidence in the euro-zone have generally remained upbeat, but retail sales growth has slowed. The rate of unemployment in Germany and France fell in 2006, although it is not yet clear the extent to which this, and an improvement in consumer confidence, will be maintained. In Italy, employment gains from labour market reform are coming to an end, while in France similar reforms are unlikely in the short term.

## US INTEREST RATES ARE PEAKING WHILE THE DOLLAR DEPRECIATION STILL HAS SOME WAY TO GO

US interest rates have been on hold at 5<sup>1</sup>/<sub>4</sub>% since June 2006, while in Japan official interest rates were raised to 1<sup>1</sup>/<sub>4</sub>% in July 2006 and then to 1<sup>1</sup>/<sub>2</sub>% in May 2007. In the euro-zone, interest rates rose steadily throughout 2006 and

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into early 2007. The European Central Bank then held rates at 3<sup>3</sup>/<sub>4</sub>% from March, before increasing them to 4% in June 2007. The ECB remains hawkish and ready to raise rates further, while the Federal Reserve seems to be waiting to see how the US economy and inflationary pressures develop while oil prices remain high. In both cases, we expect interest rates to peak in 2007, with a more gradual reduction in the euro-zone over 2007-10. In Japan, the expectation is that interest rates will rise only gradually as there are no obvious inflationary pressures to control as yet.

After pausing briefly between December 2006 and March 2007, the depreciation of the dollar against the euro and sterling has continued, and it fell in April to new lows against both currencies. With the US current account deficit standing at around 6<sup>1</sup>/<sub>2</sub>% of GDP and the US economy slowing, the dollar is likely to continue to depreciate into 2008. With the UK economy lying somewhere between the US and euro-zone economies, in terms of growth and interest rate cycle, we expect sterling to continue to plot a middle course between the dollar and the euro. But over 2007-10 sterling is expected to weaken a little against the euro.

#### OIL PRICES ARE EXPECTED TO FALL BACK OVER 2007-10 AND INFLATION FOR OTHER COMMODITIES SHOULD EASE

After falling in the second half of 2006, dollar oil prices rose by 20-30% between January and April 2007, due to ongoing geopolitical uncertainty. The strength of sterling will mitigate some of the impact of this rise in the UK and, despite the recent increase, we expect the average price of oil in dollars in 2007 to be lower than in 2006. If geopolitical tension does not increase, we expect that oil prices will fall back a little from recent highs.

On other commodities, inflationary pressures are expected to weaken a little in 2007 in response to slower world growth. Metals and minerals are expected to show the

steepest price rises across the commodity groupings, with inflation still reaching around 20% in 2007 as supplies remain tight, even though demand pressures are expected to ease. Agricultural raw materials are expected to be the next strongest group with inflation of around 6-7%. As more supplies are expected to come through and world economic growth slows beyond 2007, commodity prices are expected to gradually fall back more into line with long-term trends.

#### POINTS TO WATCH

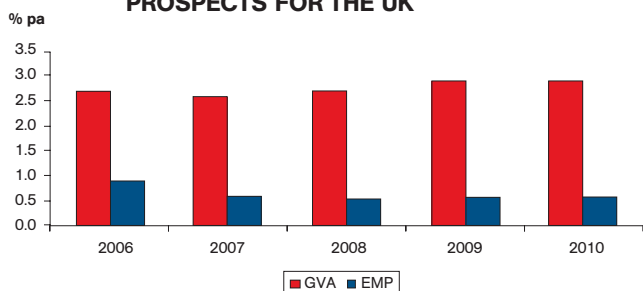
- Although the world economy has so far proved to be pretty resilient to relatively high oil prices, the more general impact of intensified geopolitical tension remains a threat to confidence.
- A key question about the near future remains whether the recovery in demand in the euro-zone will strengthen to offset the current slowdown in the US. Further rises in euro-zone interest rates are still possible in the second half of 2007, and these could dampen the pick-up in consumer confidence seen in 2006, and in domestic demand.
- Thereafter, key issues to monitor relate to the US: will the slowdown be stronger than expected, and how far, and how rapidly, will the dollar depreciate? The strength of the US housing market will be an important influence on the scale of the slowdown. A stronger depreciation of the dollar would undermine the competitiveness of UK and euro-zone exports against competitors both in the US and the Far East, whose currencies are typically pegged to the dollar.
- A key issue influencing the euro-zone towards the end of our forecast period, and beyond, is whether sufficient political will can be developed to push through much needed business and labour reforms, a lack of which has held back growth in recent years.

# The UK Economy

## KEY POINTS

- The UK economy saw a healthy and balanced recovery in 2006 that was stronger than many expected. Growth is expected to dip slightly in 2007 before strengthening a little thereafter.
- More moderate growth in the major industrial economies over 2007-10 and an expected slowing in domestic activity combine to suggest that all key UK sectors will nevertheless see an easing of demand growth over the period as compared with the period before the 2005 downturn.
- Despite five increases in interest rates since August 2006, inflation remains strong. The pick-up in headline average earnings inflation and manufacturers' price inflation in 2007 have made a further increase in interest rates likely.
- The key risks to our view about prospects for the UK context are on the downside and they are: that inflation persists and interest rate rises will be stronger than expected; the US slowdown will be sharper than expected; and that the recovery in the euro-zone will not translate into stronger domestic demand.

**CHART 2: OUTPUT AND EMPLOYMENT GROWTH PROSPECTS FOR THE UK**



Source: Panel Forecasts, June 2007.

## GROWTH OF THE UK ECONOMY WAS MORE BALANCED IN 2006

In 2006, the UK economy recovered somewhat more strongly from the slowdown of 2005 than many had expected. GDP grew a little faster than 2<sup>3</sup>/<sub>4</sub>% in 2006, and

the growth of the economy was also more balanced than expected. Household spending recovered but investment growth was even stronger, supported by strong company profits. Trade growth was strong, but the figures are distorted by Missing Trader Intra-Community fraud (a VAT fraud which involves repeated exporting and importing of the same goods). By sector, the UK recovery was also broadly based, with manufacturing, distribution and financial & business services all registering stronger growth in 2006 than in 2005. Only transport and communications saw slower growth as revenue growth in the mobile phone industry slowed, and BT's Openreach programme failed to meet demand for unbundling local loops in the broadband market. Manufacturing benefited from strong investment and export demand and from recovery in household spending. The financial & business services sector benefited from buoyant activity in merger and acquisitions.

So far in 2007, headline average earnings growth has strengthened and this looks to have underpinned consumer confidence. Retail sales growth has been healthy with year-on-year growth remaining at around 4% in April. The Confederation of British Industry's April 2007 survey shows that confidence about market conditions has improved. At the same time, however, we believe export demand is now slowing, and preliminary estimates suggest manufacturing output fell in the first three months of 2007.

## GROWTH IS EXPECTED TO SLOW SLIGHTLY IN 2007

In our Autumn 2006 short term forecast we noted that growth prospects in 2007 were particularly sensitive to the extent to which household and business investment spending would be sustained if world growth and government spending slowed together, as we expected they would. Household spending is still forecast to continue to grow, but not as rapidly, while business investment is expected to remain robust. Consequently, at just under 2<sup>3</sup>/<sub>4</sub>%, UK GDP growth is forecast to be only slightly lower in 2007 than in 2006. Manufacturing is likely to benefit from healthy business investment demand in the UK, but slower world growth and a strong pound will make

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it tough for exporters. After below-trend growth in 2007, we expect a modest pick-up over 2008-10, supported by income growth and a stronger trade performance as the euro strengthens against sterling.

#### KEY SECTORS WILL HAVE TO OPERATE UNDER TOUGHER CONDITIONS OVER 2007-10

Robust consumer confidence so far in 2007 is likely to underpin a good year overall for the distribution sector. However, its growth is likely to slow later in the year as the full effect of interest rate rises comes through, with demand for big-ticket durables likely to be most affected. The rise in interest rates is also expected to curb the growth in investment demand in the latter part of 2007 and in 2008, and support sterling against the dollar. In addition, with household expenditure growth not expected to accelerate over 2007-09, conditions for manufacturers will continue to be challenging. These conditions may also weaken domestic demand growth for financial services next year, while international demand growth for investment banking services could be affected by somewhat more subdued world growth expected from next year.

#### FURTHER INTEREST RATE RISES MAY BE NEEDED TO CONTAIN INFLATION

The Bank of England raised interest rates twice in the second half of 2006 and once again in January 2007, to 5<sup>1</sup>/<sub>4</sub>%. Despite this, Consumer Price Index (CPI) inflation rose through the period reaching 3.1% in March 2007 and breaking the ceiling within which the Bank of England is charged with maintaining inflation. In response, the Bank of England raised interest rates to 5<sup>1</sup>/<sub>2</sub>% in May and to 5<sup>3</sup>/<sub>4</sub>% in July. While there are signs that inflation could be more persistent than originally thought, with household goods and food & drink prices driving the recent rise, underlying earnings growth remains modest, and the impact of energy

prices is expected to fall out of the year-on-year comparison. Indeed, this was a factor behind the reduction in CPI inflation to 2.8% in April and 2.5% in May. However, with headline earnings (including bonuses) growth hitting a three year high in February 2007, and output-price inflation rising steadily so far in 2007, the Bank will be keen to prevent inflationary pressure feeding into expectations. A further increase in the base rate is likely in the second half of 2007.

#### NET IMMIGRATION HAS FALLEN

In our Autumn 2006 short term forecast, we indicated that growth prospects would be sensitive to any slowdown in net immigration. The latest data from the Office for National Statistics (ONS) indicate that net immigration did slow in 2005, from 223,000 in 2004 to 185,000. Although the level of immigration remains high, if this slowdown were maintained, it would lead us to revise down our view of the economy's potential growth rate, and therefore the path of this forecast.

#### RISKS TO THE UK FORECAST

The key risk to the UK position is that inflation stays strong and forces the Bank to raise interest rates even more than expected. This would result in a further strengthening of sterling, making conditions even harder for exporters. At the same time, higher rates would curb investment demand and household spending, the key supports of growth in 2007 as export demand and government spending would then slow together. Externally, a key risk is that the US slowdown is stronger than expected, with knock-on effects on confidence and demand for UK exports. The question would then become whether domestic demand for manufactures and exports in the euro-zone was strong enough to offset a more marked slowdown in the US.

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## POINTS TO WATCH

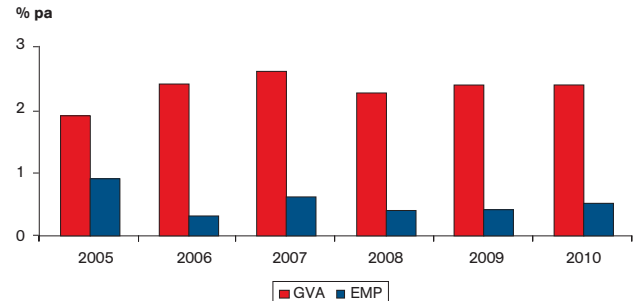
- If earnings inflation and output-price inflation fall back, this would relieve pressure on the Bank to raise rates further. Conversely, if inflationary pressures prove to be more generalised, the period of higher interest rates (and stronger sterling) could be prolonged.
- Business investment has recently been strong in response to high levels of profitability, but business confidence and expectations are not buoyant. Signs of deterioration in confidence could presage a peaking in the present investment cycle.
- Our forecast already assumes some slowing in the growth of financial and business services, especially in 2008. There are some who believe that this could be more marked, with quite widespread effects on the UK economy given that the sector now contributes nearly 30% of GDP.
- Although the government will emphasise the priorities given to spending on 'front-line services' when it publishes the results of the Comprehensive Spending Review (CSR) later this year, it will be important to identify the scale of slowdown in spending that is expected to be behind these pronouncements.

# Northwest Economy Outlook

## KEY POINTS

- Growth in the Northwest economy strengthened in 2006 after slowing sharply in 2005. We expect growth to strengthen further in 2007 to 2.6%, but then to ease back to 2.3% in 2008, followed by 2.4% in each of 2009 and 2010.
- Stronger growth in 2007 is expected to come from construction, transport & communications and public services making contributions that are expected to outweigh the anticipated slowdown in growth in manufacturing, distribution hotels & catering, and in financial & business services.
- There are signs that business confidence is currently strong among both manufacturers and service companies. However, we expect growth in manufacturing output to slow in 2007 alongside the expected weakening in world growth and weakness of the dollar before recovering gradually thereafter.
- The easing of regional growth in 2008 again reflects underlying sectoral changes, especially in financial and business services and in construction.
- Northwest labour markets weakened sharply in 2006, with employment growth slowing from just less than 1% in 2005 to a little over 1/4%. The growth in employment in financial & business services in particular was much slower. Employment growth in total is expected to strengthen to 0.6% in 2007. However, employment growth in financial & business services is likely to remain more subdued than earlier in this decade, and employment in distribution, hotels & catering is expected to fall further, albeit at a slower rate than the 1/2% fall seen in 2006. Looking further ahead, total employment growth is expected to remain at about 1/2% pa, with the strongest growth nevertheless occurring in financial & business services.

**CHART 3: OUTPUT AND EMPLOYMENT GROWTH PROSPECTS FOR THE NORTH WEST**



Source: Panel Forecasts, June 2007.

## OUTPUT GROWTH RECOVERED IN 2006 AND IS EXPECTED TO STRENGTHEN IN 2007

In 2005, output growth in the Northwest economy slowed sharply, as it did in the UK as a whole, particularly in the consumer service sectors such as retailing and hotels & catering. Manufacturing output also fell. The slowdown in household spending did not persist, and so 2006 saw quite a sharp recovery in the growth of consumer services. The strength of the world economy supported modest growth in manufacturing, and growth in financial & business services also increased alongside the improvement in the overall UK economy. Even so, we estimate that the recovery in 2006 in the Northwest was weaker than for UK.

Table 1 shows our new forecast for GVA in the Northwest and the UK and some other regions. In our Autumn 2006 short term forecast, we took the view that UK growth would peak in 2008, with growth in the Northwest likely to remain fairly steady through to 2009.

In our new short term forecast, we expect growth of 2.6% in the UK economy in 2007 to be slightly slower than that experienced in 2006, supported by strengthening household spending, and then to pick up reaching 2.8% in 2009 and 2010.

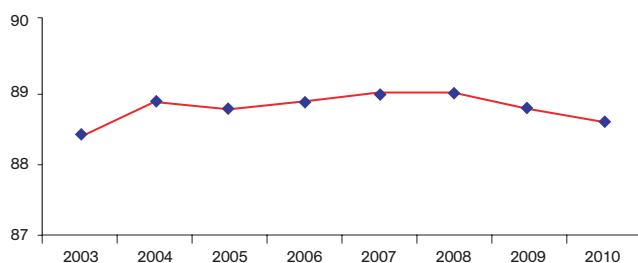
**TABLE 1: REAL GVA GROWTH (% pa)**

	2007	2008	2009	2010
CE Forecast as at February 2007.				
North West	2.4	2.3	2.5	2.5
West Midlands	1.6	2.3	2.7	2.6
London	3.2	3.0	3.1	3.1
South East	2.8	2.8	3.1	3.0
UK	2.5	2.5	2.8	2.8
Panel Forecast, June 2007.				
North West	2.6	2.3	2.4	2.4
UK	2.6	2.7	2.8	2.8

Source(s): Panel Forecasts, June 2007 and Cambridge Econometrics, February 2007.

Generally, growth in the Northwest is expected to be less strong than in the UK after 2007 with growth in all sectors except manufacturing likely to be slower than in the UK with the clearest differentials in financial and business services and in construction. Although the proportion of manufacturing in regional output has fallen a little more sharply than in the UK, the sector still contributes some 19% of GVA in the Northwest compared with less than 15% nationally.

The region is also expected to experience slower population growth than in the UK. The result is that the level of GVA per head generated in the Northwest compared to the UK average is expected to improve slightly in 2007, before falling back to 2010.

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

Source: Regional Accounts and Panel Forecasts, June 2007.

Based on the industrial structures of the Northwest's sub-regional economies, and on the relative historical performance of sectors in different parts of the region, we expect growth in 2007 to be strongest in Greater Manchester and Merseyside and weakest in Lancashire. Further ahead, prospects are most favourable in Cheshire, but somewhat less so in Lancashire and also in Merseyside, where the future path of public services spending is particularly important since this now provides a full third of the sub-region's GVA.

The strength of growth projected for the two urban sub-regions in 2007 reflects the importance of financial & business services to their economies. Confidence within the sector remains strong in Manchester in particular. In Merseyside, Liverpool is benefiting from a strong construction sector especially in the run-up to the city's being the European Capital of Culture in 2008. Further benefits from this award can be expected in 2008, but not enough to offset the passing of a peak in construction and later effects from a slower growth in public spending.

#### BUSINESS CONFIDENCE IMPROVED AT THE END OF 2006

The regular survey of businesses by The British Chambers of Commerce suggests business confidence is strong. In 2006Q4, a balance of almost 40% of firms in both manufacturing and services expected turnover to increase in the short term, with a similar proportion expecting profitability to improve. Importantly, regional confidence in both sectors is not as strong as that reported for the UK as a whole.

The increased confidence in manufacturing coincides with an improvement in home orders in particular, though this is not expected to lead to increases in employment. Within services, there has been a stronger improvement in export orders, though the outlook for employment growth reportedly weakened at the end of 2006.

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

	2007	2008	2009	2010
Cheshire	2.4	2.7	2.9	2.9
Cumbria	2.4	2.1	2.3	2.3
Greater Manchester	2.8	2.3	2.5	2.4
Lancashire	2.1	2.1	2.2	2.2
Merseyside	2.8	2.3	2.2	2.2
Northwest	2.6	2.3	2.4	2.4

Source(s): Panel Forecasts, June 2007 and Cambridge Econometrics.

**GROWTH WILL STRENGTHEN IN 2007 BUT SLOW AGAIN IN 2008**

Output growth in the Northwest recovered in 2006 as a result of a sharp increase in growth in key consumer-related services and a recovery in manufacturing output following a small fall in 2005. The outlook is for overall growth in the Northwest to build further to just over 2<sup>1</sup>/<sub>2</sub>% in 2007 with strengthening growth in construction, transport & communications and public services, contributions that are expected to outweigh the anticipated slowdown in growth in manufacturing, in distribution hotels & catering, and in financial & business services. In 2008, output growth is likely to slow to 2<sup>1</sup>/<sub>4</sub>%, with all sectors excepting public services contributing to the slowdown. However, within projected expenditure totals, the outlook for output growth in real terms in public services depends on an assumption that there will now be much tighter control of wage awards than has been in recent years.

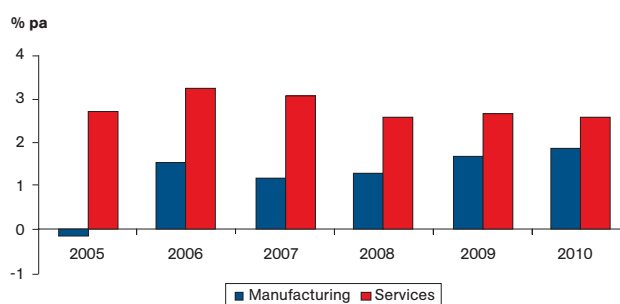
Manufacturing output in the Northwest recovered from its modest fall in 2005 to grow by just over 1<sup>1</sup>/<sub>2</sub>% in 2006, a little faster than in the sector in the UK as a whole. We expect growth in the sector regionally to slow to 1<sup>1</sup>/<sub>4</sub>% in 2007 and 2008, restricted in part by the anticipated slowdown in the world economy, before strengthening over the remainder of the forecast. However, its growth is still expected to remain below 2% pa.

Consumer-related services in the region are expected to experience slower growth in 2007 than in 2006, with the growth in household spending restricted by the weak saving position of households and the impacts of higher interest rates. Growth in output in these services is expected to slow further in 2008 within the context of slower general economic growth, before recovering towards the end of our forecast.

Financial & business services have been an important source of growth for the Northwest economy recording real output growth of 5-5<sup>1</sup>/<sub>4</sub>% in 2005 and 2006 before growing less rapidly than in the UK in 2006. Looking forward, the outlook for the sector in the Northwest is for output growth to slow further to 4<sup>3</sup>/<sub>4</sub>% 2007 and then to 3% in 2008, before recovering slightly thereafter.

Despite substantial increases in government spending on public services, revised data now indicate that output growth in recent years has not been as strong in the Northwest (and, indeed, elsewhere in the UK) in real terms as was previously thought, because of relatively high increases in earnings that have accompanied employment growth. We estimate output growth in 2006 was 1<sup>3</sup>/<sub>4</sub>% following just 1<sup>1</sup>/<sub>2</sub>% in 2004 and 2<sup>1</sup>/<sub>4</sub>% in 2005. We expect output growth to pick up again to 2% in 2007, and in later years to average just over 2<sup>1</sup>/<sub>4</sub>% pa.

**CHART 5: PROSPECTS FOR OUTPUT GROWTH IN THE NORTHWEST**



Source: Panel Forecasts, June 2007.

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#### EMPLOYMENT GROWTH WILL STRENGTHEN IN 2007

Northwest employment growth slowed sharply to less than 1/2% in 2006. It had previously averaged 1-1 1/2% pa since 2000, and is expected to pick up and average 0.6% in 2007, similar to the UK, as manufacturing employment holds steady, construction employment builds, and the growth in employment in financial & business services remains weak. Regional employment growth is expected then to remain fairly steady in 2008 and 2009, with further declines in manufacturing employment, and some recovery in employment growth in financial & business services, but not to rates seen earlier in the decade.

During 2006, the number of people unemployed in the Northwest rose, as it did in the UK as a whole. In 2007Q1, claimant count unemployment stood at 3.1% of the workforce in the Northwest, compared to 2.9% for the UK as a whole. We expect Northwest unemployment will also average 3.1% through 2007, though the prospect is for some further increase in 2008.

#### POINTS TO WATCH

- We have assumed that financial and business services in the Northwest will prove vulnerable to a national slowdown in this sector in 2008 as some activities fall back from their current peak. If the national slowdown is less pronounced than we expect, or if firms in the Northwest are less exposed because of their having a less national and international client base, the slowdown in the Northwest may not be as sharp. Conversely, the long-term gap in growth rates in this sector vis-à-vis the UK average may be larger than suggested here if its fastest growth continues to be in activities linked to the position of London in international financial markets.
- Although public spending constraints will be tighter over the forecast period, we have assumed that much tighter control of wage awards will allow output growth in real terms to be slightly higher than in the recent past. If this is not borne out in practice, real output growth in public services will be weaker than shown.
- We shall continue to monitor the performance of the sub-regional economies for indications that Cumbria and Lancashire are improving their relative performance.

# Northwest and UK GDP 2003 – 2010

**TABLE 3: SUMMARY DATA AND FORECASTS FOR THE NORTHWEST**

	<b>Units as indicated and % growth pa GVA (£2003m)</b>	<b>Consumer Spending (£2003m)</b>	<b>Unemployment Rate (%)</b>
2003	96,828 2.5	77,260 2.8	3.2 -6.5
2004	100,185 3.5	79,708 3.2	2.8 -12.2
2005	102,128 1.9	80,911 1.5	2.9 1.2
2006	104,549 2.4	82,609 2.1	3.3 13.3
2007	107,247 2.6	84,534 2.3	3.1 -5.0
2008	109,735 2.3	86,707 2.6	3.4 8.3
2009	112,399 2.4	88,729 2.3	3.3 -0.9
2010	115,099 2.4	90,904 2.5	3.2 -2.6

Source(s): Panel Forecasts, June 2007.

**TABLE 4: NORTHWEST AND UK GVA**

	<b>Units as indicated and % growth pa NW GVA (£2003m)</b>	<b>UK GVA (£2003m)</b>	<b>Nominal GVA per head (UK=100)</b>
2003	96,828 2.5	962,215 2.4	88.4 -0.7
2004	100,185 3.5	993,968 3.3	88.9 0.6
2005	102,128 1.9	1,012,853 1.9	88.8 -0.1
2006	104,549 2.4	1,040,200 2.7	88.9 0.1
2007	107,247 2.6	1,067,246 2.6	89 0.2
2008	109,735 2.3	1,096,354 2.7	89 0.0
2009	112,399 2.4	1,127,139 2.8	88.8 -0.2
2010	115,099 2.4	1,159,135 2.8	88.6 -0.2

Source(s): Panel Forecasts, June 2007.

# Northwest Sector Output

## KEY POINTS

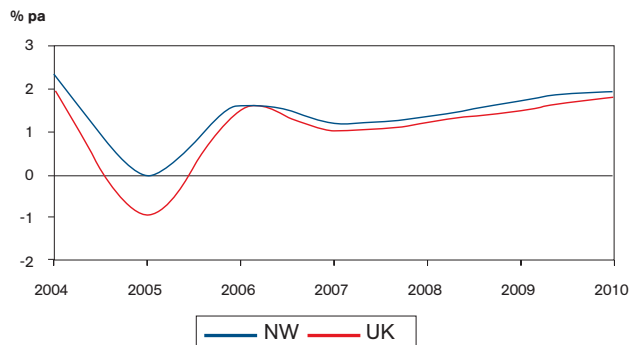
- We expect Northwest output growth in 2007 will be slightly stronger than in 2006, at 2.6%, with stronger growth in construction, transport & communications and public services outweighing the anticipated slowdown in growth in manufacturing, distribution hotels & catering and financial & business services. We foresee growth slowing again slightly in 2008 to 2.3% followed by 2.4% in 2009 and 2010.
- Although recent growth in manufacturing has been weak, it has still grown a little faster than in the UK. We expect growth to slow to 1<sup>1</sup>/<sub>4</sub>% in 2007 and 2008, restricted in part by the anticipated slowdown in the world economy, before strengthening over the remainder of the forecast. However, its growth is expected to remain below 2% pa.
- Financial & business services will remain a key driver of growth through to 2010. Growth is expected to slow in 2007 compared with 2006 and especially with rates as high as 8% pa achieved since 2003, but it will still be around 4<sup>1</sup>/<sub>2</sub>%, and between 2007 and 2010 the sector is expected to add more than any other to overall output growth in the region.
- (Charts of output in the Northwest and the UK in all the sectors discussed below are shown behind the Executive Summary at the head of this paper.)

## MANUFACTURING: a slowdown in world growth will depress growth in the short term

Manufacturing output in the Northwest grew by just over 1<sup>1</sup>/<sub>2</sub>% in 2006 after falling slightly in 2005. In both years, manufacturing in the Northwest outperformed the sector in the UK as a whole. Chemicals and pharmaceuticals and mechanical engineering have performed well in both years, while 2006 also saw output recover in aerospace, electronics and electrical engineering and metal products. In contrast, output is estimated to have fallen in motor vehicles, textiles clothing & leather, and printing & publishing.

Recent surveys give a mixed picture. The British Chambers of Commerce survey for 2006Q4 shows that while home orders remain strong, and stronger than for the UK, export orders are weak, and weaker than elsewhere in the UK.

## CHART 6: GVA IN MANUFACTURING



Source: Panel Forecasts, June 2007.

We expect manufacturing in the Northwest to continue to outperform the sector in the UK, though for rates of growth to remain modest. The outlook is for growth to slow to 1<sup>1</sup>/<sub>4</sub>% in 2007 and 2008 alongside the slowdown in world growth. Prospects should recover from 2008, but growth is unlikely to exceed 2% pa.

In the short term, chemicals and electronics are expected to continue to be among the stronger sectors, while output looks likely to fall further in motor vehicles and textiles, clothing & leather.

The motor vehicles sector is important to the Northwest, accounting directly for 5% of manufacturing. In terms of output, the Northwest has the largest motor vehicles sector in the UK. However, output in the sector fell in 2005 and 2006, and the immediate prospects are for a modest further fall (1<sup>1</sup>/<sub>2</sub>%) in 2007. Prospects further ahead may be more favourable. In April 2007, GM announced that its Vauxhall plant at Ellesmere Port had been selected as one of the sites that would build the new Astra. Until this announcement, there had been great concern regarding the long-term future of the plant. New production is scheduled to start in 2010, but production volumes will only

then reach levels seen in 2005. No net increase in employment is expected to accompany the new production. Production volumes at the plant fell by over 40,000 (25%) in 2006. The Halewood plant in Merseyside is now producing both Land Rover's Freelander 2 model and Jaguar's X-type, which should safeguard the plant to 2015 subject to what may happen if Ford sells Jaguar and Land Rover, and the brands go to different buyers.

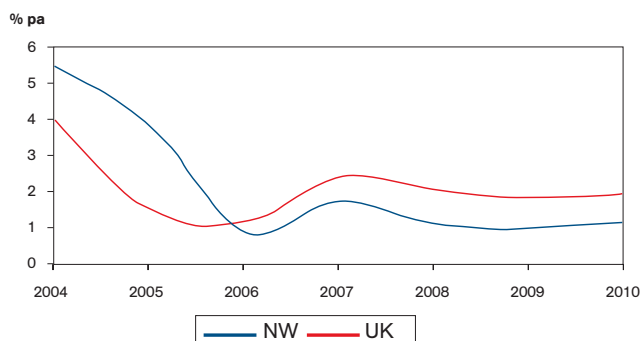
The Northwest chemicals sector comprises a strong mix of activities, from major Pharma R&D and production, bulk and specialist chemicals production facilities around Runcorn, and smaller production facilities elsewhere in the region. Recent news in the sector has been mixed. AstraZeneca announced in February 2007 its intention to reduce employment at its manufacturing site in Macclesfield by 700, although output volumes are not expected to be affected. PZ Cussons is to invest £26m in a new production and research operations at Salford. Production at the new site is expected to start in 2008.

The government's decision to proceed with the next generation of nuclear submarine systems provides some long-term support to BAE Systems' activities in Barrow-in-Furness. Activity at the yard has increased over the last couple of years and before the announcement the yard said it had several years of guaranteed work, but that the medium and longer term prospects were very uncertain.

**CONSTRUCTION:** Growth will pick up slightly in 2007 but will remain modest through the forecast

Output in 2006 grew by just under 1%, a much slower rate than any recorded since 2001. It remains our view that output growth will pick up modestly in 2007, to average 1<sup>3</sup>/<sub>4</sub>% but will fall back again in 2008 and remain at just over 1% pa through the remainder of the forecast. Activity in 2007 will still be influenced by construction related to Liverpool's role as European Capital of Culture in 2008, although our opinion is that the amount of new work being commissioned in the region as a whole is just offsetting completions.

**CHART 7: GVA IN CONSTRUCTION**



Source: Panel Forecasts, June 2007.

Major projects that are expected to start during the period of this forecast include the £250m mixed-use redevelopment in the Talbot Gateway area of Blackpool, for which work is expected to start in 2008. There are also a series of major housing investments about to start that will last beyond our short-term forecast horizon of 2010. These include the £320m investment planned for the renewal of Holt Town, and the development of Lower Broughton in Salford.

**SERVICES:** Sentiment is strong and the sector will continue to drive growth

Surveys continue to show that services firms are optimistic about future growth opportunities and employment prospects. A balance of firms continue to report rising orders, although the increase in home orders does not appear to be as strong as for services in the UK as a whole, and a balance of almost half of firms expect turnover and profitability to increase in the short term. We expect this to be reflected in stronger growth in services than in manufacturing over the forecast, particularly in financial & business services.

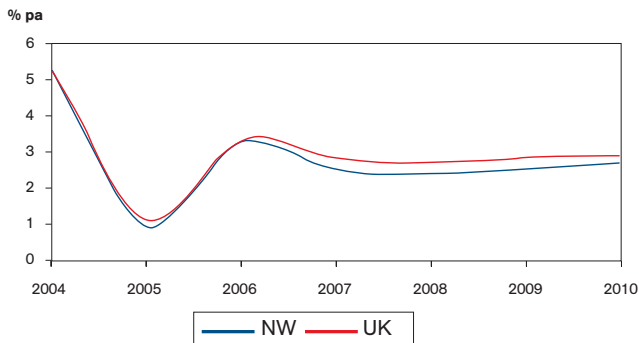
**DISTRIBUTION, HOTELS AND CATERING: growth will slow in 2007 and 2008 alongside weaker household spending**

Evidence was emerging at the time of our Autumn 2006 short term forecast that consumer spending was strengthening during the second half of the year and this has been borne out. This recovery in demand helped raise growth in distribution, hotels and catering in 2006 to just over 3%. The improvement was most marked in hotels & catering, where output is estimated to have grown by almost 5% following negligible growth in the previous year.

The attraction of the region's primary retail centres is recognised with Manchester and Liverpool being ranked within the top ten retail centres in the UK. The second tier retail centres are also receiving investment. Preston is seeing the extension to the St George's Shopping Centre and the extensive refurbishment of the Fishergate Centre.

We believe that the immediate prospects for the sector are for growth to weaken to 2<sup>1</sup>/<sub>2</sub>% in 2007 and 2<sup>1</sup>/<sub>4</sub>% in 2008, in line with the growth in household spending.

**CHART 8: GVA IN DISTRIBUTION, HOTELS & CATERING**



Source: Panel Forecasts, June 2007.

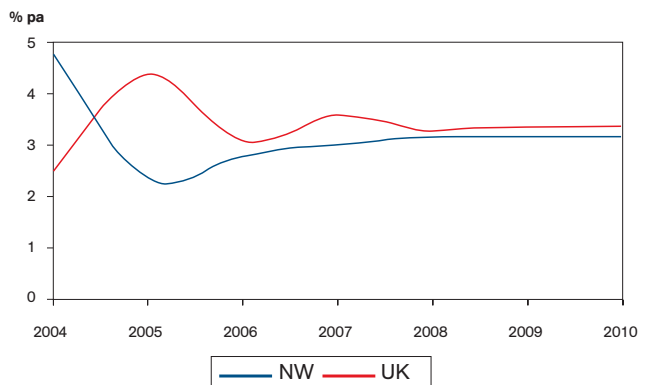
Tourism is an important sector to the Northwest economy, with 28m people visiting the region annually. Tourism to the region should be encouraged if the initial decision by the Casino Advisory Panel to site the first 'super casino' in the region is eventually accepted. This Panel recommended that the venue be sited in Manchester, while regional bodies recommended that it be sited in

Blackpool. However, development plans remain on hold as the Panel's recommendation was rejected by Parliament.

**TRANSPORT AND COMMUNICATIONS: growth is expected to pick up in 2007 and remain above 3% pa through the forecast**

Output growth in the Northwest transport & communications sector was estimated at 2.8% in 2006, faster than in 2005 but below the rates of the preceding years. We expect growth to pick up to 3% in 2007, despite a weakening in the overall economy, and to average 3<sup>1</sup>/<sub>4</sub>% pa towards the end of the forecast. It is therefore expected to be one of the strongest-growing sectors in the Northwest economy.

**CHART 9: GVA IN TRANSPORT & COMMS**



Source: Panel Forecasts, June 2007.

Further investment is being made in the region's international gateways. Air transport in the region is dominated by Manchester Airport, which handled around 22<sup>1</sup>/<sub>2</sub>m passengers in 2006, a similar volume to that in 2005. In contrast, the smaller airports have seen the strongest growth in passenger number. For example, the number of people using Liverpool John Lennon airport rose by 12<sup>1</sup>/<sub>2</sub>% to around 5m in 2006 while the smaller Blackpool airport saw passenger traffic increase by almost 50% to over 550,000. Further large increases in passengers are projected for each airport, with 42m passengers projected for Manchester Airport by 2015. Clearly, achieving growth on the scale being planned for

brings with it increased tension between economic growth in the region and some of its other sustainable development objectives such as targets for Greenhouse Gas emissions from the region.

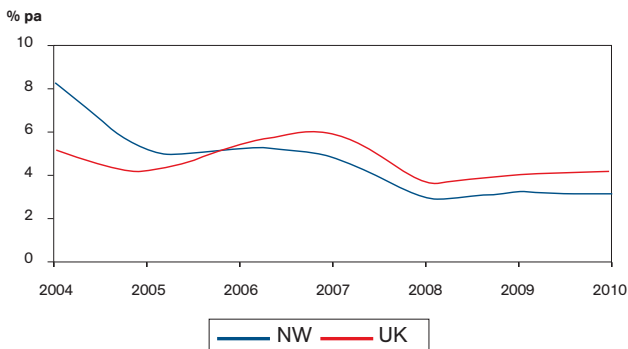
Within the communications sector, the Northwest will not be immune from the government proposal to close a number of post offices in an effort to place the Post Office on a more stable financial footing. Nationally, 2,500 post offices are expected to be closed over 2007-2009.

**FINANCIAL AND BUSINESS SERVICES: Growth set to slow to 4<sup>3</sup>/<sub>4</sub>% in 2007, but still will remain strong**

Financial & business services saw growth slow sharply in recent years from over 8% in 2004 to 5-5<sup>1</sup>/<sub>4</sub>% in 2005 and 2006. However, with the economy as a whole growing by only 2-2<sup>1</sup>/<sub>2</sub>% pa, the sector clearly remained an important focus of growth for the region.

The outlook in 2007 is for output growth in the sector in the Northwest to slow further. However, this is still expected to be around 4<sup>3</sup>/<sub>4</sub>%. A further slowdown is expected in 2008 to 3% before growth returns to around 3-3<sup>1</sup>/<sub>4</sub>% pa in 2009 and 2010.

**CHART 10: GVA IN FINANCIAL & BUSINESS SERVICES**



Source: Panel Forecasts, June 2007.

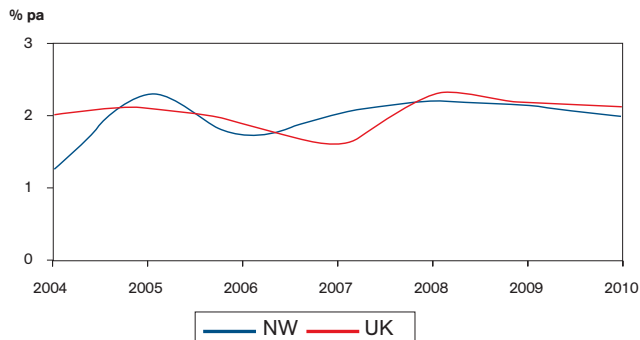
The Northwest financial services sector has a strong presence of regional private equity companies, insurance and an emerging cluster of firms specialising in personal debt management. All these segments have been performing well recently. The region has also attracted call centre activities in the past, but the vulnerable nature of this type of activity is illustrated by Barclaycard's decision to close a call centre in Manchester as part of a wider move by the company to relocate activities to India.

We noted in our Autumn 2006 short term forecast that a point to note was whether there was an increasing representation of higher value added activities undertaken in the sector. We therefore find it encouraging that the financial sector in Manchester in particular has taken an initiative to promote itself to the sector in London to seek closer links through direct investment, and also by trying to secure some of the higher value activities currently not undertaken in the region. However, Manchester faces strong competition from Leeds, Birmingham Edinburgh and Glasgow in its claim to be the UK's second financial centre after London.

**GOVERNMENT AND OTHER SERVICES: Growth is set to average 2-2<sup>1</sup>/<sub>4</sub>% pa to 2010**

We expect government and other services will also continue to grow over the next few years, though the outcome of the forthcoming Comprehensive Spending Review on the level and pattern of government spending will greatly influence the rate of growth that can be expected towards the end of our forecast. It remains our working assumption 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, a view that was confirmed by the aggregate projections published in March's Budget.

**CHART 11: GVA IN PUBLIC AND OTHER SERVICES**



Source: Panel Forecasts, June 2007.

Data now indicate the sector's output growth in recent years has not been as strong in the Northwest as was previously thought, as inflation is now thought to have been higher (and hence real output growth lower). We estimate growth in 2006 was  $1\frac{3}{4}\%$ , and this followed growth of just  $1\frac{1}{2}\%$  in 2004 and  $2\frac{1}{4}\%$  in 2005. We expect growth to pick up again to 2% in 2007, a faster rate of growth than is expected in the UK as a whole, and to average just over  $2\text{-}2\frac{1}{4}\%$  pa beyond that.

The largest development in 'other services', which is grouped with public services, remains the impending transfer of BBC activities from London to Salford by 2010. It is hoped that the move will provide the core for a new major creative and cultural cluster, capable eventually of supporting 16,000 jobs. A major consortium of 15 northern universities has been formed to work to maximise the benefits of this cluster for the north of England.

**POINTS TO WATCH**

- We shall monitor for signs that productivity growth in public services is increasing from the relatively poor outcomes achieved in recent years.
- We shall also continue to look out for any increased representation of higher value-added activities within Northwest financial & business services, and for what happens to net growth of supporting activities of the kind that grew rapidly earlier in the decade.
- A key issue influencing the euro-zone towards the end of our forecast and beyond is whether the political will can develop to push through much needed business and labour reforms. This could have important consequences for exports of manufactured goods.

# Northwest Sector Output 2003 – 2010

**TABLE 5: NORTHWEST SECTOR OUTPUT**

£2003m 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
2003	711	119	18,555	1,411	5,946	15,893	7,770	18,160	23,185	96,828
	-1.1	-6.1	-0.3	-7.2	5.4	3.9	3.3	6.3	1.2	2.5
2004	727	116	19,002	1,354	6,271	16,727	8,143	19,649	23,478	100,185
	2.2	-2.4	2.4	-4.1	5.5	5.2	4.8	8.2	1.3	3.5
2005	727	124	18,991	1,358	6,513	16,890	8,333	20,639	24,010	102,128
	0.0	6.8	-0.1	0.3	3.9	1.0	2.3	5.0	2.3	1.9
2006	714	128	19,291	1,325	6,570	17,437	8,567	21,722	24,415	104,549
	-1.8	3.0	1.6	-2.4	0.9	3.2	2.8	5.2	1.7	2.4
2007	697	123	19,514	1,339	6,685	17,869	8,826	22,767	24,910	107,247
	-2.4	-3.7	1.2	1.1	1.8	2.5	3.0	4.8	2.0	2.6
2008	697	124	19,768	1,340	6,759	18,281	9,109	23,457	25,454	109,735
	0.0	0.9	1.3	0.1	1.1	2.3	3.2	3.0	2.2	2.3
2009	696	123	20,107	1,345	6,825	18,745	9,400	24,205	25,993	112,399
	-0.1	-0.9	1.7	0.4	1.0	2.5	3.2	3.2	2.1	2.4
2010	702	123	20,498	1,351	6,903	19,242	9,700	24,952	26,513	115,099
	0.8	0.3	1.9	0.4	1.1	2.7	3.2	3.1	2.0	2.4

Source(s): Panel Forecasts, June 2007.

# Northwest Expenditure

## KEY POINTS

- We expect the growth in household spending to strengthen to 2<sup>1</sup>/<sub>4</sub>-2<sup>1</sup>/<sub>2</sub>% in 2007, alongside a recovery in employment growth.
- Investment growth is expected to remain strong, averaging 4-5% pa to 2010. Manufacturing and services are both fairly optimistic about short-term investment prospects, and in the transport infrastructure and public services there is a considerable amount of investment planned for the longer-term.

## HOUSEHOLD SPENDING: Growth strengthened in 2006 and is expected to recover further in 2007 alongside a pick-up in household income

Nationally, household spending slowed sharply in 2005H1, but recovered through the second half of the year and through 2006. The result was growth in 2006 of about 2%, moderate in comparison with the 3-3<sup>1</sup>/<sub>2</sub>% pa seen over 2002-04.

We expect the recent pattern of growth in household spending in the Northwest to have been similar to that for the UK, with growth strengthening in 2006 following a slowdown in 2005. However, growth in 2006 is expected to have been slower than in the UK as a whole, as a result of the relatively slower growth in employment in the Northwest and the weaker saving ratio (indeed, household spending has exceeded household income consistently over recent years).

The pattern of future household spending in the Northwest is also likely to mirror that for the UK as a whole, with growth recovering further in 2007, to 2<sup>1</sup>/<sub>4</sub>% pa, and to 2<sup>1</sup>/<sub>2</sub>% in 2008. Growth is likely to be maintained at around 2<sup>1</sup>/<sub>2</sub>% through to 2010. The anticipated recovery in household spending in 2007 will be supported by the likelihood of stronger income growth resulting from a recovery in rates of employment growth. However, the

weak financial position of households, and the impact of the higher interest rates, will dampen this positive influence. A slight improvement in the saving ratio is expected over the forecast period.

## FIXED INVESTMENT: Growth will remain strong through the forecast

The nature of investment means its time profile is often erratic and, in the case of investment in regional economies, data are limited. This said, we consider it likely that investment in the Northwest will rise by 4<sup>1</sup>/<sub>4</sub>% in 2007, and that the rate of growth will remain at 4-5% pa through to 2010.

Surveys indicate a balance of both manufacturing and service companies have revised up their investment plans recently, but that the magnitude of the upward revisions slowed in the second half of the year. We expect manufacturing investment to recover in 2007 after falling in 2006, and to grow by 3%. We also expect investment by financial & business services to strengthen in 2007 and 2008.

Public sector investment will continue to be an important factor supporting overall regional investment growth. In August 2006, the government announced the go-ahead for a new £112m hospital development in Salford. This followed the announcement in April 2006 that the £338m redevelopment of St Helens and Whiston hospitals would proceed.

Considerable investment continues to be made in the region's transport infrastructure to secure long-term benefits. For example, £100m is being invested in improving the Manchester Metrolink network by 2009 while the Department for Transport (DfT) announced in July 2006 a 10-year investment programme for the Northwest, totalling £1<sup>1</sup>/<sub>4</sub>bn.

# Components of Northwest Expenditure 2003 – 2010

**TABLE 6: NORTHWEST EXPENDITURE**

<b>£2003m and % growth pa</b>					
	<b>Household Expenditure</b>	<b>Government Consumption</b>	<b>Investment</b>	<b>Exports</b>	<b>Imports</b>
2003	77,260 2.8	23,269 1.6	18,310 1.3	73,053 0.3	83,668 0.1
2004	79,708 3.2	23,770 2.2	19,516 6.6	75,142 2.9	85,513 2.2
2005	80,911 1.5	24,310 2.3	20,234 3.7	75,869 1.0	86,191 0.8
2006	82,609 2.1	24,863 2.3	21,215 4.8	76,703 1.1	88,259 2.4
2007	84,534 2.3	25,475 2.5	22,122 4.3	77,074 0.5	90,186 2.2
2008	86,707 2.6	26,026 2.2	23,025 4.1	78,196 1.5	92,873 3.0
2009	88,729 2.3	26,620 2.3	24,164 4.9	79,719 1.9	95,709 3.1
2010	90,904 2.5	27,233 2.3	25,139 4.0	81,483 2.2	98,514 2.9

Source(s): Panel Forecasts, June 2007.

**TABLE 7: NORTHWEST HOUSEHOLD INCOME AND SPENDING**

<b>Units as indicated and % growth pa</b>						
	<b>Household Disposable Income (£m)</b>	<b>Household Spending (£m)</b>	<b>Saving (£m)</b>	<b>Saving Ratio (% of disp. income)</b>	<b>Household Disposable Income (£2003m)</b>	<b>Household Spending (£2003m)</b>
2003	76,996 4.2	77,260 4.8	-264 -304.0	-0.3 -295.8	76,996 2.2	77,260 2.8
2004	79,761 3.6	81,063 4.9	-1,302 393.3	-1.6 376.2	78,428 1.9	79,708 3.2
2005	83,429 4.6	84,312 4.0	-882 -32.2	-1.1 -35.2	80,064 2.1	80,911 1.5
2006	86,917 4.2	88,053 4.4	-1,137 28.8	-1.3 23.6	81,543 1.8	82,609 2.1
2007	90,952 4.6	92,057 4.5	-1,105 -2.8	-1.2 -7.1	83,519 2.4	84,534 2.3
2008	95,226 4.7	96,461 4.8	-1,236 11.9	-1.3 6.9	85,596 2.5	86,707 2.6
2009	99,561 4.6	100,778 4.5	-1,217 -1.5	-1.2 -5.8	87,657 2.4	88,729 2.3
2010	104,191 4.7	105,503 4.7	-1,312 7.7	-1.3 3.0	89,774 2.4	90,904 2.5

Source(s): Panel Forecasts, June 2007.

# Northwest Labour Markets

## KEY POINTS

- Employment in the Northwest is expected to increase by 0.6% in 2007, with manufacturing employment holding steady and the growth in financial and business services remaining subdued.
- Employment growth in total is expected to remain relatively steady in 2008 and 2009, with further falls in manufacturing, and a recovery in employment growth in financial and business services. An additional 23,500 jobs are expected in the region's financial and business services by 2010.
- Employment growth in the Northwest is set to match UK growth in 2007, but then to lag a little behind UK growth to 2010, reflecting somewhat weaker growth than the UK in output and in productivity.

## EMPLOYMENT: Improvements in employment growth in the Northwest are expected

In our Autumn 2006 short term forecast, we expected the region's slow employment growth to continue into 2007, with overall growth for the year at 0.3%, significantly lagging the UK rate of 0.9%. Our reassessment of the latest trends suggests that employment growth in the Northwest in 2006 was weaker than previously estimated, at 0.3%. The growth in employment is expected to pick up and average 0.6% in 2007, with the number of employee jobs rising strongly after a modest fall in 2006.

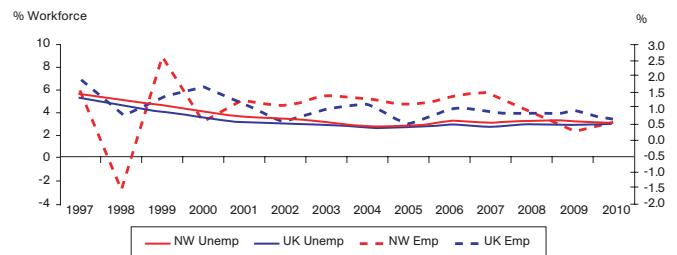
A reasonably strong rate of growth in manufacturing output for 2007 is expected to stem the loss of jobs in the sector this year. Ford at Halewood in Merseyside intends to produce Land Rover's new Freelander 2 model alongside Jaguar's X-type. Alongside this, Vauxhall's at Ellesmere Port has won the production of the new Astra. Employment growth rates in financial and business services and in other services are expected to remain unchanged in 2007, whilst growth in construction is expected to strengthen. Growth in transport and communications is expected to weaken in 2007 whilst the

rate of employment decline in distribution, hotels and catering will slow marginally.

## UNEMPLOYMENT: Set to decline in 2007

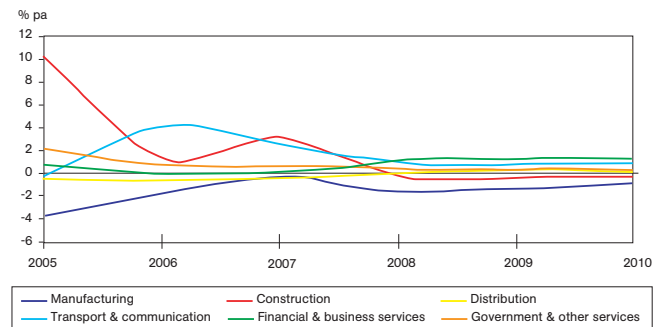
During 2006, unemployment in the Northwest rose more rapidly than in the UK as a whole although, in line with our Autumn 2006 short term forecast, we still expect unemployment rates to decline throughout the coming year. In 2007Q1, regional claimant count unemployment stood at 3.1% of the workforce compared to 2.9% for the UK as a whole. Although we expect employment to continue to increase in 2008, this is not likely to be sufficient to prevent unemployment from increasing in that year, before declining again in 2010 when employment growth picks up again.

**CHART 12: RECENT DEVELOPMENTS IN THE LABOUR MARKET**



Source: Panel Forecasts, June 2007.

**CHART 13: NORTHWEST SECTORAL EMPLOYMENT GROWTH**



Source: Panel Forecasts, June 2007.

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**OCCUPATIONS: the Northwest has a relatively large weighting of lower-level occupations**

The continued greater importance of manufacturing in the Northwest than in the UK as a whole is one reason why the region has a higher proportion of low-level occupations. Similarly, the Northwest's proportion of high-level jobs is lower than the UK average. But it is also the case that, compared with the UK average, the North West tends to have a greater representation of lower-level occupations in any given industry, and this is reflected in the region's lower level of productivity.

**POINTS TO WATCH**

- We shall monitor whether the growth in employment in the Northwest is sustained through 2007, and whether unemployment falls as a consequence.
- We shall look for any sign that the increase in women's participation, which was marked up to and including 2004, is coming to an end.
- We shall also monitor what is happening regarding skills shortages and skills gaps throughout the Northwest.

# Northwest Labour Markets 2003 – 2010

**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)
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 2.1	2.9 1.2	2.7 0.2
2006	3,034 -0.1	3,414 0.3	116 14.0	3.3 13.3	3.0 8.5
2007	3,059 0.8	3,435 0.6	110 -4.5	3.1 -5.0	2.9 -3.1
2008	3,079 0.6	3,448 0.4	120 9.0	3.4 8.3	3.0 6.3
2009	3,099 0.7	3,463 0.4	120 -0.5	3.3 -0.9	3.1 1.2
2010	3,120 0.7	3,480 0.5	117 -2.2	3.2 -2.6	3.0 -2.5

Source(s): Panel Forecasts, June 2007.

# Northwest Sector Employment 2003 – 2010

**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
2003	24	2	465	10	200	787	212	575	1,048	3,323
	4.5	-10.1	-3.2	-32.9	1.7	1.4	1.7	4.8	2.1	1.4
2004	23	2	451	8	206	803	215	590	1,077	3,373
	-4.8	-10.2	-3.1	-21.6	2.8	2.1	1.3	2.5	2.8	1.5
2005	21	2	435	8	227	801	215	595	1,100	3,404
	-9.5	3.8	-3.4	0.5	10.4	-0.2	0.0	0.9	2.2	0.9
2006	20	2	429	8	230	797	224	596	1,109	3,414
	-4.5	2.1	-1.6	4.1	1.5	-0.5	4.4	0.2	0.8	0.3
2007	17	2	429	8	238	795	231	597	1,118	3,435
	-10.9	-7.3	0.0	3.9	3.3	-0.2	2.8	0.2	0.8	0.6
2008	17	2	423	8	238	798	233	605	1,125	3,448
	-3.5	0.1	-1.4	-3.4	0.0	0.4	1.0	1.3	0.6	0.4
2009	16	2	418	8	238	803	235	613	1,131	3,463
	-3.6	-0.8	-1.2	-3.0	-0.1	0.6	0.9	1.3	0.6	0.4
2010	16	2	415	8	238	808	237	621	1,136	3,480
	-2.8	-0.8	-0.7	-3.6	0.0	0.6	0.9	1.3	0.5	0.5

Source(s): Panel Forecasts, June 2007.

# Northwest Prices and Earnings

## KEY POINTS

- Inflationary pressures picked up through the second half of 2006 and into 2007 and there is evidence that firms are now increasing prices in response. We expect the Bank of England will raise interest rates further to ensure inflation does not accelerate.
- The growth in average earnings in the UK as a whole picked up at the end of 2006, due in particular to the level of bonus payments. We do not expect this growth to accelerate further if, as anticipated, price inflation is controlled. Average earnings in the Northwest are expected to rise by 4<sup>1</sup>/<sub>2</sub>% pa through to 2010, a similar rate of growth as is expected for the UK as a whole.

## PRICES AND INFLATION: Inflation has picked up during 2007 but we do not believe that this will be sustained

The various measures of inflation all indicate that inflationary pressures have increased in recent months. In March 2007, the rate of Consumer Price Inflation (CPI) rose sharply to 3.1% from 2.8% in the previous month, requiring the Governor of the Bank of England to write an open letter to the Chancellor of the Exchequer explaining the reasons for this. Inflation, as measured by the Retail Price Index (RPI) or the index excluding mortgage payments, RPIX, was higher still, at 4.8% and 3.9% respectively. The rate of inflation fell back in April and May, but even so the Bank of England raised interest rates to 5<sup>1</sup>/<sub>2</sub>% in May and 5<sup>3</sup>/<sub>4</sub>% in July.

Large increases in energy and food prices helped raise inflation and are expected in time to fall out of the year-on-year comparison. Indeed, this was a factor behind the reduction in CPI inflation to 2.8% in April. However, there are signs that inflation could be more persistent than originally thought, with household goods also seeing relatively strong price increases and headline earnings (including bonuses) growth remaining strong. Further increases in the base rate still seem, likely in the second half of 2007.

Input price inflation has fallen back sharply to 2.3% in March 2007. A year earlier, it was running at around 15%.

There is increasing evidence that producers are now able to increase prices. Output price inflation has increased steadily from the middle of 2006, and now stands at just over 2<sup>1</sup>/<sub>2</sub>%.

Companies remain concerned about the outlook for the price of raw materials. The British Chambers of Commerce Survey continues to report a large balance of companies, especially among manufacturers, facing pressure to raise prices in response to the price of raw materials and other factors. The survey indicates the pressure on manufacturers is greater in the Northwest than in the UK as a whole, possibly reflecting the strong presence in the region of key international producers in price-sensitive sectors.

## EARNINGS: The growth in average earnings will average 4<sup>1</sup>/<sub>2</sub>% pa

Nationally, the headline measure of average earnings picked up sharply at the end of 2006. Growth in the year to February 2007 stood at 4.6%. The strongest growth in average earnings was in the private sector, at just under 5%. The average growth in public sector earnings was 3.2%. Evidence from the Annual Survey of Hours and Earnings (ASHE) indicates that earnings growth in the Northwest has been weaker than in the UK as a whole, by around 1/2pp. A major factor behind the growth in private sector earnings (and overall earnings) was the level of bonus payments. If these are excluded from the calculation, then underlying average earnings growth nationally has been on a slightly downward trend since mid-2005. Growth in this measure in the year to February stands at 3.6%.

We think it likely that the growth in average earnings will average 4<sup>1</sup>/<sub>2</sub>% in 2007, a slight increase on the average for 2006. While headline inflation rates have increased, the expectation is that rates will fall back again through 2007. The government has also signalled its expectation that increases in public sector pay will remain modest at around 2-2<sup>1</sup>/<sub>2</sub>% pa. Both factors will help to limit private sector wage increases.

# Northwest Prices and Earnings 2003 – 2010

**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)
2003	19,385 3.5	19,984 3.1	181.3 2.9	180.0 2.8	100.0 1.8
2004	20,069 3.5	20,737 3.8	186.7 3.0	184.0 2.2	101.5 1.5
2005	19,981 -0.4	20,610 -0.6	192.0 2.8	188.2 2.3	103.7 2.2
2006	21,957 9.9	22,425 8.8	198.0 3.1	193.5 2.8	105.8 2.0
2007	22,949 4.5	23,413 4.4	203.6 2.8	198.1 2.4	107.9 2.0
2008	24,017 4.7	24,493 4.6	209.1 2.7	202.1 2.0	110.1 2.0
2009	25,104 4.5	25,604 4.5	213.7 2.2	206.3 2.1	112.3 2.0
2010	26,211 4.4	26,740 4.4	218.7 2.3	210.8 2.1	114.7 2.1

Source(s): Panel Forecasts, June 2007.

# Northwest Construction and Housing

## KEY POINTS

- The value of construction output increased by 3.2% in 2006, picking up in the second half of the year.
- The acceleration in house prices has been accompanied by a fall in the number of housing transactions, suggesting that affordability is restraining demand.

## CONSTRUCTION ORDERS: Growth in 2006 was sustained by housing work

Construction orders increased in 2006, although values have fallen since the first half of the year. New housing orders are significantly above their 2005 levels. However, the level of infrastructure and other public orders has dropped substantially. While there was growth in private industrial orders in the second half of 2006, private commercial orders fell.

The value of construction output in 2006 was 3.2% higher than in 2005, due primarily to housing-related work, which offset a decline in infrastructure output. We expect continued modest growth for the region's construction industry sustained through particular areas of activity throughout the region.

## HOUSE PRICES: Inflation and house prices accelerated through 2006

The Northwest housing market has continued to track that for the UK as a whole. House price inflation accelerated through 2006, as a result of a strengthening of activity in 2005 and despite increases in interest rates during the year. At the year end, regional prices were on average 5<sup>1</sup>/<sub>2</sub>% higher than a year earlier, compared with 7<sup>1</sup>/<sub>2</sub>% in the UK. The acceleration in price inflation since the beginning of 2006 has been accompanied by a significant fall in the number of transactions in the market, both in the Northwest and the UK as a whole, suggesting that affordability considerations may finally be beginning to restrain demand. It is likely that the further interest rate rise expected during 2007 will dampen activity further.

## HOUSING INVESTMENT: Underlying prospects for public and private investment are good

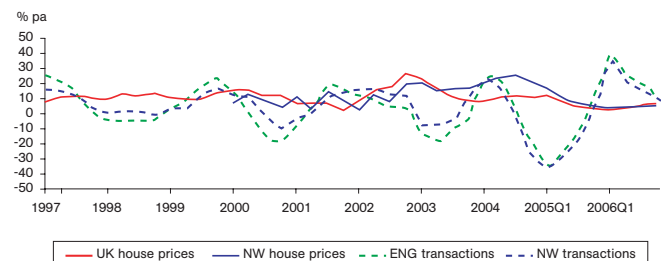
The short-term prospects for housing investment in the region remain comparatively favourable. In 2006, the number of new dwellings started rose by 11<sup>1</sup>/<sub>2</sub>% in the Northwest compared to 6% overall in England. Growth in housing starts by registered social landlords increased by 92% compared to 9% growth by private enterprise; together these offset a decline in housing starts by local authorities. However, potential downside risks for the longer term include a lack of first-time buyers to the housing market due to increasing interest rates and high levels of consumer debt.

There is substantial public sector investment in housing in the Northwest: of the nine Housing Market Renewal Areas in England, four are in the Northwest. The Regional Economic Strategy (RES) has identified that housing market failure is a constraint on economic growth and is monitoring actions to increase the availability of an attractive and affordable housing stock throughout the region.

The total funds available from the single housing pot in the Northwest are £249.5m in both 2006/07 and 2007/08, this will be allocated against the strategic housing issues facing the region identified in the Regional Housing Strategy.

The substantial investment in housing renewal will continue beyond this short-term budgeting period. For example, the planned renewal of Holt Town in Manchester is a £320m project involving the construction of over 4,000 dwellings over the next 10-15 years.

**CHART 14: RECENT DEVELOPMENTS IN THE HOUSING MARKET**



Source: Communities and Local Government.



