Rebalancing: UK region and city economic forecast

EY
Building a better working world

EY’s region and city reports

EY’s region and city reports provide the latest UK economic forecast and examine the current economic trends and outlook for the next three years in 12 regions and 18 cities across the UK. They represent a detailed and directly comparable analysis of UK economic performance at a regional and city level. This report is part of our Economics for Business programme, providing analysis and insight to help our clients understand the economic environments in which they operate, in the UK and globally.

ey.com/uk/economics

In this report

Mark Gregory
EY Chief Economist UK & Ireland
mgregory@uk.ey.com
@markgregoryey
uk.linkedin.com/in/markgregoryuk

I'm delighted to welcome you to the first edition of Rebalancing: UK region and city economic forecast, a new series that we intend to publish every six months.

Now, with the concerted move towards the devolution of political and economic decision-making away from London to the UK's regions and cities, we feel the time is right to track and monitor economic developments at these levels more closely than ever before. As the momentum behind devolution grows, it will become increasingly important for all stakeholders — national and regional government, policymakers, companies, inward investment agencies, media organisations, voters and more — to understand what is happening in local economies across the country. Our reports will provide that much-needed insight, allowing us to track progress towards the aim of rebalancing the UK economy.

In producing this report, we're deepening and broadening our long-standing relationship with the EY ITEM Club. For many years, EY ITEM have used HM Treasury's economic model to produce the UK's quarterly economic forecasts. This report takes as its starting point the latest EY ITEM Club UK Autumn economic forecast, and drills down to examine the current economic trends and outlook for the next three years in 12 regions and 18 cities across the UK.

We see this analysis of regional and city economic trends as the perfect complement to our annual UK Attractiveness Survey, which tracks UK foreign direct investment (FDI) and the UK's attractiveness to overseas investors at a national, regional and city level. Together the two reports will allow us to track how the combination of domestic and foreign activity is impacting the UK's regions.

As this is our first report, we have analysed regional and city economic growth since 2012, the start of the UK's sustained recovery, to provide a context against which to judge our projections. The comparison of historical and projected performance highlights both the opportunity and the challenge of rebalancing the economy.

The recent performance of Manchester and the resurgence of automotive manufacturing in the West Midlands clearly illustrate the potential of targeted initiatives to drive relatively faster growth on a geographic basis. However, our projections also show how national policy initiatives may work against regional activity if those geographies are relatively more exposed to certain policy changes. Hence there is a clear need to ensure that national and regional economic policies are designed to complement each other, especially in key areas such as public expenditure reform, manufacturing, technology and trade. We discuss these points in more detail in the report.

Overall, we believe that this economic forecast for the UK's regions and cities is the right report, launched at the right time. We hope you find it interesting and informative. And given that this is the first edition, we're keen to receive feedback and suggestions on how we can make it as useful and relevant as possible. So please feel free to contact me.

Foreword

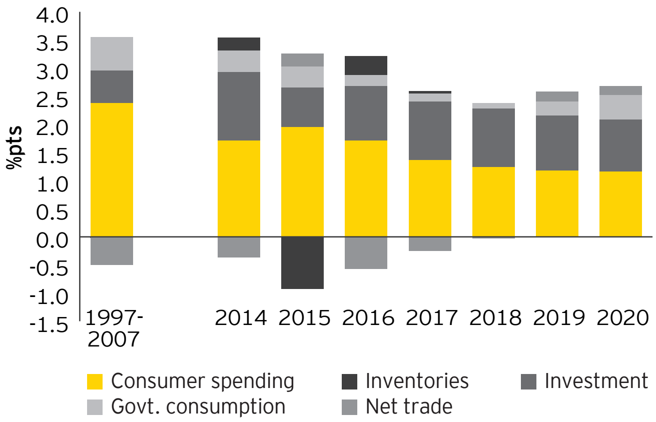
The UK's current regional economic landscape

Rebalancing at the macro level ...

The recent EY ITEM Club UK Autumn economic forecast describes how a combination of low inflation and rising average earnings is making 2015 a bumper year for UK consumer spending, translating into expected GDP growth of 2.5%. However, the forecast illustrates that 2016 looks set to be tougher for consumers, with higher inflation, public expenditure reform and likely rises in interest rates outweighing the introduction of the national living wage. These factors, together with continued tight fiscal policies, will slow UK GDP growth to just 2.4% in 2016 and 2.3% in 2017.

The national economy is rebalancing with the strong recent consumer contribution to growth set to be replaced by higher business investment in the next two to three years. The national living wage, the apprenticeship levy and the need to drive productivity will create the conditions for this increase in corporate capital expenditure. In parallel, increased capital spending by government on infrastructure and the support for housebuilding announced in the Autumn Statement should further stimulate UK fixed investment.

UK: Contributions to GDP growth



***Source:** EY ITEM Club*

... and at the regional level

The macro drivers will have clear — albeit varying — regional impacts. Understanding and predicting these is at the core of the findings presented in this report.

Government policy is a major driver of regional outcomes. The Autumn Statement confirmed that the thrust of policy is to reshape public finances and welfare over the next few years. A central element of this is the move to devolve greater economic decision-making power, which offers opportunity to the UK's regions and cities. However, other aspects of the reform agenda, especially cuts to public expenditure, will be felt most keenly in regions with higher unemployment and a greater exposure to state spending as a share of local economic activity.

But policy is not the only driver of regional economic performance. Individual sectors of the economy will develop in different ways and hence the existing economic structure of a local area and its relative exposure to different sectors will influence outturns. So will other externally driven factors such as migration. Our projections take all these effects into account at the regional and city level.

Historic regional performance: a more unbalanced economy?

Strong growth in the South …

Our research clearly shows that London has been the fastest-growing component of the UK economy since 2012 and we expect London's Gross Value Added (GVA) to grow by 3.4% for 2015 as a whole, compared with the UK's projected GDP growth of 2.3%. But it is not just London that is growing faster than the UK average. The East and South West have both grown in excess of the average rate since 2012. Our forecast for 2015 suggests that the three southern English regions outside of London — the South East, South West and the East — are also likely to have outperformed the UK as a whole on GVA in 2015, all with growth rates well above 2%.

… but clear evidence of the potential for change elsewhere …

The analysis does however also serve to illustrate the potential benefits that devolution can bring. Both the North West and West Midlands have posted growth in excess of the national average since 2012. In the former, this growth in part reflects the successful initiatives undertaken in Manchester, discussed in more detail in our cities section, which are now being used to create the foundations of the 'Northern Powerhouse'. In the latter, the resurgence in manufacturing, especially automotive, has contributed to strong relative performance.

Employment and GVA growth by region

Region	Employment growth (%)		GVA growth (%)	
	2014	2015	2014	2015
North East	1.7	0.1	2.7	0.9
North West	3.1	0.8	3.1	1.8
Yorkshire and Humber	3.2	0.8	2.5	1.7
East Midlands	2.8	0.8	3.1	1.8
West Midlands	2.2	0.6	3.2	1.6
East	4.1	1.4	2.6	2.5
South East	2.5	0.9	2.4	2.3
South West	4.6	1.5	3.1	2.5
London	4.8	2.1	3.6	3.4
Northern Ireland	1.8	0.5	2.0	1.7
Scotland	3.4	0.9	2.7	1.9
Wales	3.5	0.8	3.0	1.7
United Kingdom	**3.4**	**1.1**	**3.0**	**2.3**

Source: *EY ITEM Club*

What is GVA?

Gross Value Added (GVA) measures the contribution to the economy of each individual producer, industry or sector in the UK. GVA is used in the estimation of Gross Domestic Product (GDP).

What is it used for?

GVA (at current basic prices; available by industry only) plus taxes on products (available at whole economy level only) less subsidies on products (available at whole economy level only) equals GDP (at current market prices; available at whole economy level only).

GVA + taxes on products - subsidies on products = GDP.

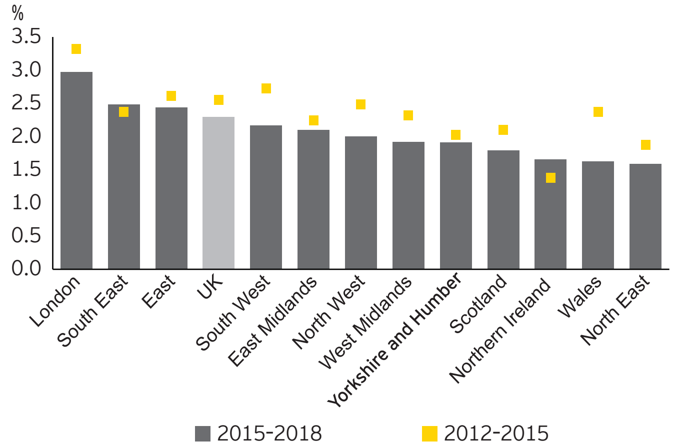
Source: Office for National Statistics website – http://www.ons.gov.uk/

It is good news that targeted strategies by geography and sector can generate improved economic performance. The challenge is to sustain and build on these examples because there is much to do. Consider for example, the North East which will record GVA growth of only 0.9% in 2015. This performance partly reflects the region's relative reliance on public expenditure within the UK, and partly its heavy reliance on manufacturing – a sector that faces particular problems given the current strength of the pound against the euro. Boosting this and other challenged regions will require strong, concerted and coordinated policy, supported by significant resources.

… but this is a long game …

Looking forward, our forecasts largely point to more of the same. We project that London will continue to outperform all other UK regions through to 2018 with average annual GVA growth of 3.0%. Its neighbouring regions, the East and the South East, will also outperform the UK average, with the South West just below the UK average.

Annual average GVA growth



Source: *EY ITEM Club*

We expect that the weakest parts of the UK in terms of GVA growth will be the economies on the country's geographical periphery: the three devolved nations of Scotland, Wales and Northern Ireland, together with the North East. The traditional English industrial heartlands such as the North West, West Midlands, and Yorkshire and Humber will occupy an intermediate position between the two extremes, both economically as well as geographically – perhaps underlining the fact that geographical position and accessibility within the UK do seem to affect the level of economic activity and hence action is required to 'rebalance' the economy.

… even for the 'Northern Powerhouse'…

From our projections, it's clear that we don't expect the Government's 'Northern Powerhouse' ambitions to have a radical economic impact during our forecast period through to 2018. At best the economic boost will be felt more in the next decade than this one, given that major infrastructure schemes such as HS2 will not come into operation for another ten years. As work starts so the benefits will start to flow but these will be concentrated initially in the areas where work is taking place. Similarly, the impact of the devolution of powers to cities such as Manchester, Birmingham and Liverpool will become effective only when budgets can be aligned and funds used more efficiently.

… because the situation will not change overnight

London's growth is the result of a number of factors but its existing economic structure is clearly a very important influence on performance. London's economy looks very different to the rest of the UK. In 2015, we forecast that 16% of London's GVA will be accounted for by Financial Services and Insurance, 13% by Professional Services, with Information and Communications contributing 11%. For the UK as a whole, the respective shares are 7%, 8% and 6%. As these are expected to be three of the fastest-growing sectors over the next three years, London's existing strength provides the basis for stronger future performance.

London is much less exposed to the plan to reduce the national debt and turn deficit into surplus than other regions, as public spending and health account for 9% of London's GVA compared to 12% nationally. These policies will continue to bite via the proposed changes to welfare, excluding old-age pensioners, and cuts in operating expenditure in many government departments. As we noted earlier, these moves will particularly affect regions with lower wages and higher unemployment, resulting in the North-South divide tending to widen rather than narrow.

The regional analysis shows us how different factors drive relative economic performance across the UK. This report now moves on to analyse activity in the UK's cities. This will allow us to understand at an even more specific level what is driving outturns and hence what needs to be done to make rebalancing a reality.

Spotlight on: migration

Net migration into the UK is currently running at 330,000 a year, the highest level on record and up from 205,000 in 2009. This rise underlines why migration has been a significant factor underpinning recent growth in the UK population, boosting it by over one million in the past five years.

Net migration boosts the UK economy ...

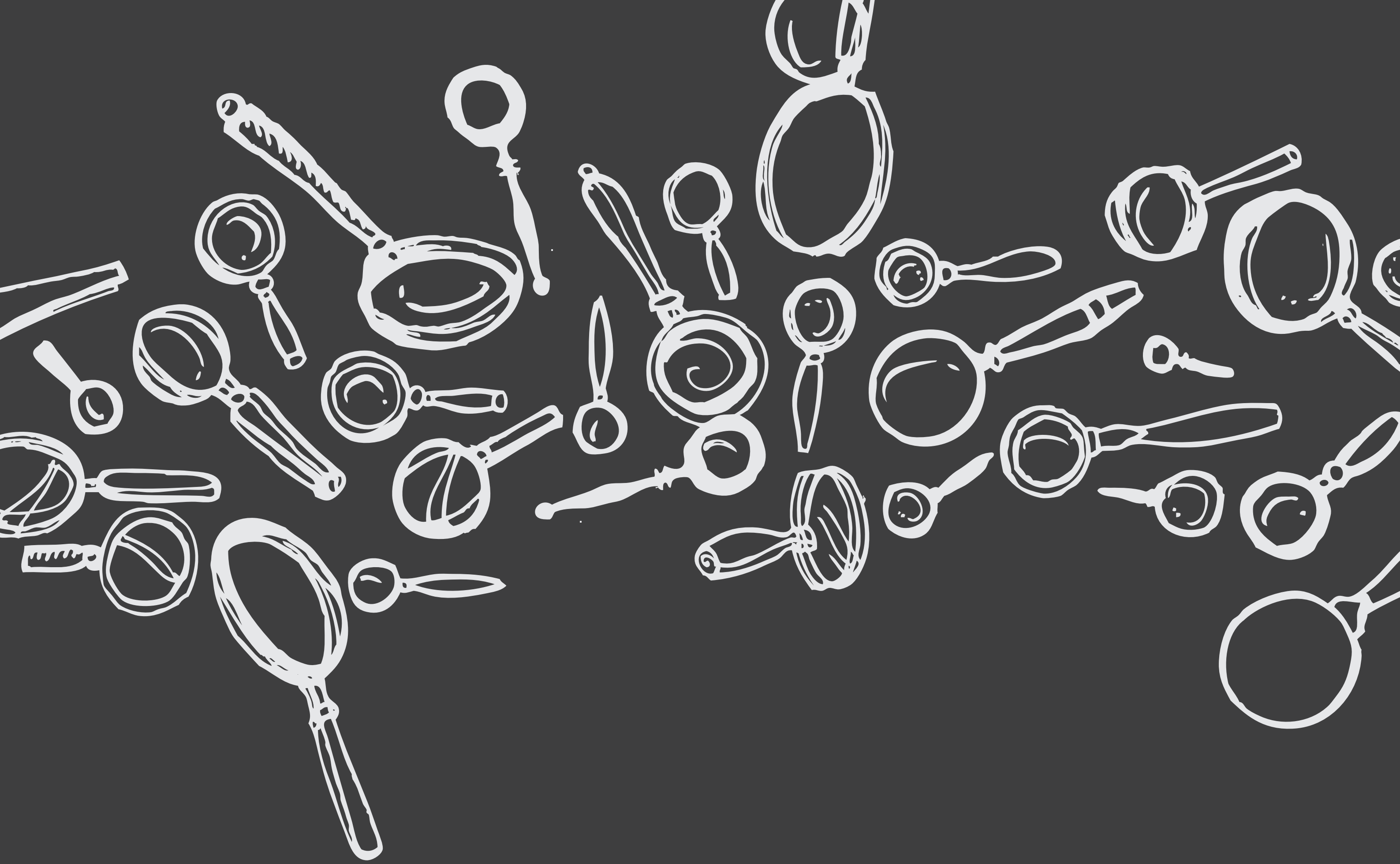
Since the main reasons for migrating to the UK are work-related or involve formal study, the majority of migrants are of working age and do tend to have a higher propensity to be in work than the population as a whole. It is therefore unsurprising that the majority of studies conclude that migration is beneficial for economic growth in total as it leads to an increase in the size of the labour force and its collective pool of skills – thus increasing the economy's potential capacity. At the same time, net inflows of people also boost demand, as migrants spend within the economy.

... but mainly goes into faster-growing regions

All regions of the UK have enjoyed population gains from migration in the past five years. However, the largest numbers of migrants have been attracted to the southern regions, particularly London and the South East – a similar trend to recent employment growth, and one that we expect to continue. It is likely that growth and migration feed off each other. Higher migration drives higher growth but a better performing economy is also more attractive to people looking for work.

As well as attracting larger numbers, London's migration pattern also differs from other UK regions, and consists of high net inflows of international migrants together with net outflows of internal migrants to other UK regions. Net migration in London in 2014 was +38,800, comprising net international migration (+107,400) and net internal migration (-68,600).

A closer look shows that London's net internal migration is negative for all age bands except people in their 20s, pointing to an inflow of students. Among the over-30s, there is a net outflow from London, possibility reflecting high housing costs or environmental and social factors, as people have families and seek somewhere greener or quieter to settle.



Population change

'000s	Population 2015	Working age migration 2015-2018	Other migration 2015-2018	Natural increase 2015-2018	Population 2018
North East	2,631	15.1	2.9	15.1	2,664
North West	7,165	18.9	4.3	69.3	7,258
Yorkshire and Humber	5,391	24.6	2.5	57.8	5,476
East Midlands	4,680	45.2	17.2	43.0	4,786
West Midlands	5,756	31.5	7.1	72.4	5,867
East	6,086	79.9	34.2	67.8	6,268
South East	8,969	108.9	45.4	93.9	9,217
South West	5,477	73.2	35.7	29.6	5,615
London	8,701	196.3	-86.2	283.7	9,095
Northern Ireland	1,854	8.1	-1.1	30.3	1,891
Scotland	5,370	20.2	4.8	19.0	5,414
Wales	3,110	18.3	4.4	18.1	3,151
United Kingdom	**65,190**	**640.2**	**71.2**	**800.0**	**66,702**

Source: *EY ITEM Club*

Economic performance by the UK's cities: more complex than 'North-South divide'

Strong performance by some southern cities ...

Given our projection that the regions close to London will tend to grow faster than the rest of the UK through to 2018, it's hardly surprising that we expect that Luton and especially Reading will do well in terms of GVA growth, with Bristol, Exeter and Cambridge close behind. Indeed our forecast indicates that Reading will marginally outperform London to record the highest GVA growth of any UK city through to 2018, at 3.1%.

Employment and GVA outlook 2015-2018

	Total employment			GVA (£m, 2012)	
	(000s) 2015	Change (000s) 2015-2018	% growth 2015-2018	% of the UK 2015	% growth 2015-2018
Aberdeen	205.3	0.6	0.1	0.9	1.9
Belfast	233.3	3.2	0.5	0.7	1.9
Birmingham	556.9	13.4	0.8	1.5	2.1
Bristol	290.8	10.8	1.2	0.9	2.6
Cambridge	109.0	3.4	1.0	0.3	2.5
Edinburgh	355.1	10.2	1.0	1.4	2.2
Exeter	102.2	3.7	1.2	0.3	2.7
Glasgow	428.8	10.1	0.8	1.3	2.1
Hull	128.6	1.0	0.3	0.3	1.6
Inverness	49.8	0.3	0.2	0.1	1.5
Leeds	462.5	11.9	0.8	1.3	2.3
Liverpool	257.4	4.6	0.6	0.7	1.9
London	5,607.8	276.5	1.6	22.9	3.0
Luton	105.0	5.1	1.6	0.3	2.8
Manchester	372.9	13.0	1.2	1.1	2.5
Newcastle	192.2	3.1	0.5	0.5	1.8
Reading	108.2	4.8	1.4	0.4	3.1
Southampton	128.9	3.5	0.9	0.4	2.1
United Kingdom	**33,695**	**863**	**0.8**	**100**	**2.3**

Source: *EY ITEM Club*

At first sight, this projection might appear to confirm that the UK's cities are set to fit in with a general widening of the 'North-South divide'. Newcastle, Hull and Liverpool all face a challenging outlook, Belfast is set to grow relatively slowly and even Leeds, generally seen as a city on the up, will only grow at the national average rate according to our forecasts. Birmingham is also expected to lag the country as a whole as manufacturing slows.

However, the reality is more complex. For example, we expect that Southampton will slightly underperform the UK average in terms of GVA growth as will Edinburgh and Glasgow — and will lag behind the performance of Manchester and Leeds.

… but it is not a simple story …

These findings clearly highlight that the deeper the geographic level we analyse economic performance at, the more insight we develop into how policy and different industrial structures influence economic performance. A comparison of some of the fastest-growing cities in the South East and East regions really brings this point home.

There are specific reasons for the relatively poor outlook for Southampton. The city and its hinterland have suffered not only from the loss of manufacturing capacity generally, but also from pressure on defence spending — which has had a dramatic impact on the Portsmouth Dockyards, and in turn on many contractors in the supply chain within the conurbation. Public Administration and Health account for 14% of GVA in the area compared to 10% for the South East as a whole in 2015, so as public expenditure is squeezed the impact will fall disproportionately on Southampton.

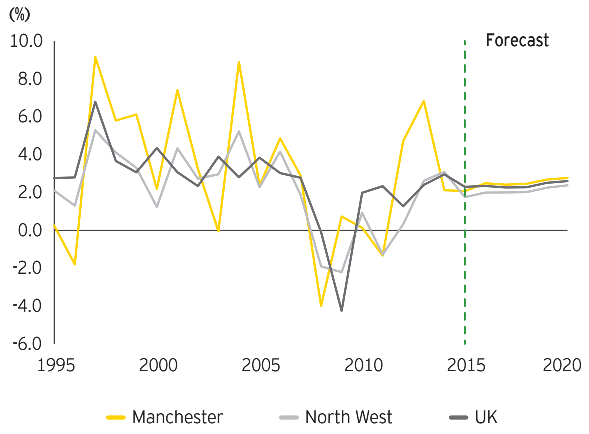
The performance of Reading, Cambridge and Luton illustrates the importance of sectors in determining performance. We forecast that the GVA of Information and Communications and Professional Services will grow by 13% over the next three years. By contrast, Manufacturing will grow by 3% and Public Administration will shrink by 1% over the period. This translates into strong performance for Reading where the Information and Communications sector accounts for more than twice as large a share of GVA as the national average. Professional Services account for twice as much of Cambridge's GVA as the national average, underpinning the city's strong performance.

… the opportunity lies in the detail

But it is Luton which offers the most interesting perspective. Luton's GVA is forecast to grow at 2.8% over the next three years, significantly above the national average of 2.3%. While it has a reasonably strong Professional Services sector, it is also the case that Manufacturing accounts for 16% of GVA, and Administrative Services for 10%. These sectors are not among the fastest growing but contribute to a diversified local economy which also includes a strong contribution relative to the national average from Transport and Logistics.

In similar vein, the strong GVA performance — both historical and projected — for Manchester reflects a number of factors including the substantial investments made over more than a decade in revitalising the city centre. Real Estate accounts for 18% of the city's GVA, the highest share in the UK, and includes the commercial opportunities offered by Manchester Airport and its surrounding business infrastructure; the city's strong surface transport links; and a clear positive reputational effect. Manchester also gains from being particularly strong in Professional Services and Financial Services but the real story is how targeted initiatives can drive superior growth. Manchester's projected growth of 2.5% in GVA puts it in the group of top performing cities and shows that geography is no barrier to progress if the right initiatives are put in place. The challenge is to develop and implement the right mix of policies.

GVA growth, 1995–2020



Source: *EY ITEM Club*

The national and policy perspective: time to narrow the economic imbalances

Rebalancing will be good for all …

As the most recent UK forecasts from both EY ITEM Club and the Office for Budget Responsibility (OBR) make clear, the UK economy is recovering — but moving to a faster level of growth is challenging. The aim of rebalancing growth to maximise the potential of all the UK's regions and cities is therefore essential if the UK is to move to a higher sustainable rate of economic growth. In this context, we believe our economic forecasts for the UK's regions and cities provide a lot of food for thought — not least for government policymakers seeking to stimulate a faster and more balanced pattern of growth across the UK, and for local, regional and city authorities seeking to claim their fair share of that growth.

… but it will take time

Our projection is that with some notable exceptions, primarily among the major northern cities, the North-South divide is set to widen still further over the next three years. The potential of targeted initiatives such as the 'Northern Powerhouse' is clear but these efforts will take years to have a noticeable impact. And in the meantime, other policy initiatives such as ongoing austerity and welfare cuts will drive the economy in the other direction.

The three clear messages to emerge from our report are:

- Firstly, national and regional policies have to be coordinated. Top-down policies such as welfare reform can cut across efforts to boost local growth. All national policy assessment should identify significant variations in regional impact so that mitigating action can be taken.
- Secondly, relative sector performance is a critical driver of relative geographic performance. Rebalancing the economy is not just about adjusting for geographic differences, the interaction with sector must also be considered.
- Finally, the city and regional landscape is becoming more competitive. Successful local development strategies around the world tend to be based upon specialisation in a small number of sectors with policy integrated to support this focus.

This leads us to three areas for national and regional/city level policymakers to work together on.

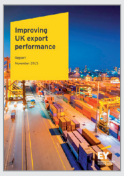
- It is clear that technology will be a key component of UK growth both within the Information and Communications sectors but also more broadly across other sectors of the economy. London, the South and East are clearly winning the battle for skilled resources in these areas and benefitting from superior growth as a result. Policies must be designed to facilitate both the development of a greater number of skilled Science, Technology, Engineering and Mathematics (STEM) resources outside of the current hot markets and the retention of those skills once training is complete.
- Manufacturing remains important to many regions and cities of the UK, especially outside of the South and East. The resurgence in the Midlands shows what is possible and as our recent report *Reshoring manufacturing — time to seize the opportunity* demonstrated, the UK has a once in a generation opportunity to capture share in selected industries as the world economy changes. Coordination will be key in identifying appropriate sector opportunities by region/city, and funding over and above that generated regionally will be required to support the transformation of UK capability to a competitive global level.
- Trade generally will be another important component of regional and city growth strategies. UK Trade & Investment in particular has a key role to play once again, ensuring the appropriate levels of support and coordination across the UK, such as helping individual areas develop realistic plans for sectors which offer the opportunity to build a local base for successful trade.

In an unpredictable and increasingly competitive global economy, guiding the UK towards more balanced growth will not be easy. Devolution is a clear step in the right direction but enabling the regions alone will not be sufficient. National policy must be designed to complement regional policy.

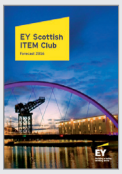
Economics for Business

EY Economics for Business provides knowledge, analysis and insight to help business leaders understand the economic environments in which they operate, both in the UK and within the Global economy.
EY is well-positioned to help businesses understand the implications of economic change. Economics for Business brings you:

EY ITEM Club UK forecast
A macroeconomic forecast for the UK



Improving UK export performance
Report which looks at the UK export market's performance



EY ITEM Club Scottish forecast
A macroeconomic forecast for Scotland

EY Capital Confidence Barometer
A survey which gauges corporate confidence of senior executives globally and in the UK

EY Economic Eye
An all-island macroeconomic forecast for Ireland

EY UK Attractiveness Survey
A survey assessing the UK's appeal as an investment destination

EY UK region and city economic forecast
A macroeconomic regional and city forecast

EY UK Profit Warnings
Insight into profit-warning trends

Stay connected

Website: ey.com/uk/economics

Economics for Business blog: markgregoryeconomics.ey.com

@MarkGregoryEY @EY_ITEMClub

economics@uk.ey.com

Definitions

London	Greater London GOR
Newcastle	Newcastle upon Tyne LA
Liverpool	Liverpool LA
Manchester	Manchester LA
Hull	Kingston upon Hull UA
Leeds	Leeds LA
Birmingham	Birmingham LA
Cambridge	Cambridge LA
Luton	Luton LA
Reading	Reading UA
Southampton	Southampton UA
Bristol	Bristol LA
Exeter	Exeter LA
Belfast	Belfast LGD
Aberdeen	City of Aberdeen CA
Edinburgh	City of Edinburgh CA
Glasgow	City of Glasgow CA
Inverness	Highland CA*

GOR = Government Office Region
UA = Unitary Authority
LA = Local Authority District
CA = Council Area
LGD = Local Government District
* Highland CA figures have been adjusted to reflect the Inverness economy

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

ED None

44447.indd (UK) 12/15. Artwork by Creative Services Group Design.

In line with EY's commitment to minimise its impact on the environment, this document has been printed on paper with a high recycled content.

ey.com/uk