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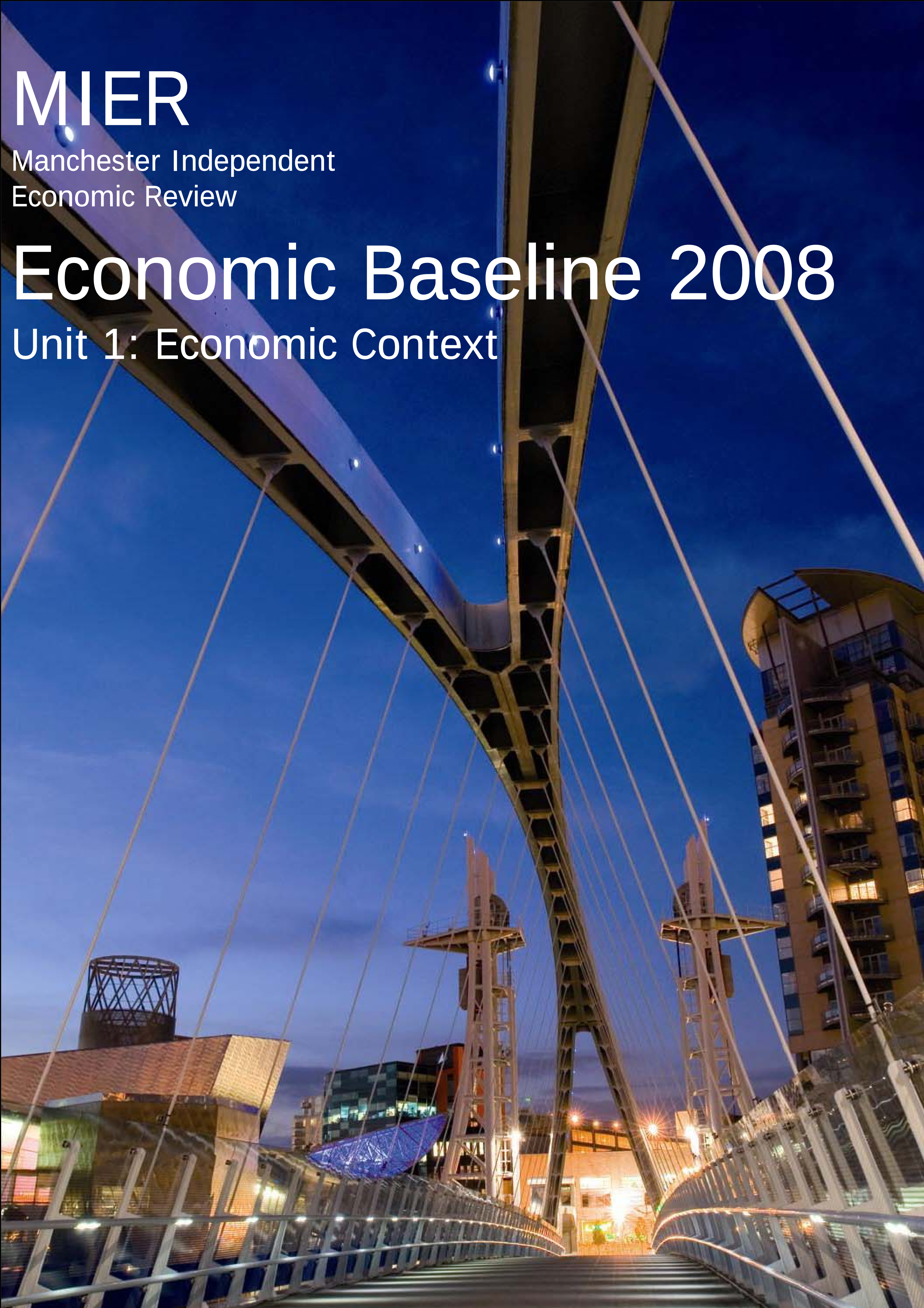
Manchester Independent
Economic Review

Economic Baseline 2008

Unit 1: Economic Context



Manchester Independent Economic Review

Economic Baseline Assessment

UNIT 1: ECONOMIC CONTEXT

November 2008

Welcome to the Manchester Independent Economic Review - Economic Baseline

Manchester is a unique city. Its size and potential make it the natural capital of a rejuvenated North. Yet despite sustained growth over recent years, the fragility of its economic base remains; as does the uneven distribution of its new prosperity. What steps do the private and public sectors need to take to ensure Manchester fulfils its true promise?

This document is part of an economic baseline study that has been produced for the Manchester Independent Economic Review (MIER) - a Commission of prominent economists and business leaders, with responsibility for commissioning high quality research to inform decision-makers in the City Region. The full Review (www.manchester-review.org.uk) will provide a fresh economic narrative, which will enhance the debate regarding Manchester's future.

The full baseline study provides a balanced assessment of both the strengths and challenges facing the economy and labour market. This includes: an overview of recent economic trends at national; regional; and sub-regional levels; the structure and performance of the business base; the factors determining competitiveness in the conurbation including the supply and demand for labour and skills; a summary of the Manchester City Region's offer in terms of key infrastructure and cultural assets; as well as providing a range of alternative scenarios for change over the next decade.

The baseline should help promote an understanding of the key economic factors governing the future of the City Region and inform future decisions and action. We trust that you will find it a valuable tool in supporting your own contribution to Manchester's future.

Economic Strategy Team.

The Commission for Economic Development, Employment and Skills.

Summary of Key Findings: Economic Context

After years of strong growth, the world economy has experienced marked deceleration towards the end of 2008. Global growth is now projected to slow substantially in 2008, and there is no clear consensus on the medium-term outlook. As is the case nationally, current economic conditions are set to put downward pressures on growth in the Northwest and the Manchester City Region, with unemployment rising and business conditions worsening in the manufacturing and services sectors. The challenge is to make sure that the City Region's diverse knowledge economy is able meet the demands of this current economic crisis and even become stronger and more dynamic through it. Beyond the short-term, partners must continue to plan strategically for long-term growth.

Eurozone and the UK

- Real GDP growth has stalled in the eurozone in 2008, following a first-quarter rebound, and indicators now suggest that many countries are moving close to or into recession.
- Having performed strongly in 2007, averaging around 3.0 percent growth[1], the UK economy experienced tighter conditions in 2008. Current independent forecasts for economic growth are much lower, averaging around 1.0 percent.
- It is likely that the UK is now in recession, as the credit crunch and the weakening in the American and Euro area economies is turning out to be more severe than previously thought.
- A significant slowdown is emerging not only in the UK services sector, but also in both consumer spending and UK business investment.
- Although the UK's unemployment rate has increased in the last one to two years, especially among young unskilled school-leavers, it is still relatively low at around 5.3 percent of the economically active population (ILO Unemployment).
- UK housing market activity has significantly lowered and house price inflation has eased in the latter part of 2007. Inflation has risen to and remains significantly above the Bank of England's 2 percent target in 2008, and, despite a downward tendency, may remain so for a prolonged period.
- In the currency markets, sterling has weakened considerably. This has been especially the case during 2008. The pound has now also significantly weakened against the dollar.
- Long-term economic drivers include the increasing influence of: demographic and socio-economic change; globalisation; innovation and technological diffusion; increasing pressures on resources and global climate.

Northwest

- Since 2000 the growth gap between GVA in the Northwest and the UK has narrowed - but the GVA per head gap with the UK average has remained stable at around 12 to 13 percentage points.
- The region has seen significant growth in the number of employees (+221,000) between 1999 and 2004. However a significant number of ancillary jobs and similar have been created, putting downward pressure on productivity levels (in the short term at least).
- Productivity levels in nearly all service sectors in the Northwest remain below the UK average, and there is considerable potential for the Northwest to grow in the long-term, especially in and around Manchester, by placing continuing emphasis on narrowing the region's skills gap with the UK.
- As is the case nationally, current economic conditions are set to put downward pressures on growth in the Northwest, with unemployment rising and business conditions worsening in the manufacturing and services sectors.

Manchester City Region

- The Manchester City Region is now the main driver of the Northwest economy and home to a population of over 3 million residents (47% of population in the NW).
- Almost 90 percent of the net increase in the Northwest's population, and almost half (48%) the net increase in the Northwest's employment, were related to MCR's growth in the last decade.
- The City Region generates 50 percent of the Northwest's total economic output and is continuing to develop as a major centre of knowledge intensive industries.
- Despite significant growth over the last decade, the annual GVA growth rates between 1999 and 2004 in the MCR (2.4%) and GM (2.5%) are both lower than the UK (2.9%).
- However, this masks significant differences in GVA between City Region districts, with e.g Cheshire & Warrington operating at very high GVA per capita levels, close to those of London and the South East.
- Recent surveys of businesses suggest confidence in the profitability of exporters in the Northwest and Greater Manchester has decreased in 2008, with local companies signalling low confidence levels.
- Businesses have continued to report rising input costs, which is mirrored by a decline in investment intentions.
- The service sector witnessed a considerable fall in the number businesses reporting increasing sales and orders in the first half of 2008, accompanied by a fall in the proportion reporting growth in export sales.

Contents

1 ECONOMIC CONTEXT

This document is part of a comprehensive economic baseline of the Greater Manchester (GM) and Manchester City Region (MCR) economy. This section of the baseline provides a summary of the world, national and regional economic context, exploring past trends and forecasts for the next decade.

1.1 The World economy in 2008

After years of strong growth, the world economy has experienced marked deceleration towards the end of 2008. Global growth is now projected to slow substantially, with recovery forecast towards the end of 2009[2].

As reported in the *October 2008 International Monetary Fund (IMF) World Economic Outlook*, the financial crisis that first erupted with the US sub-prime mortgage collapse in August 2007 has impacted across the global financial system, including emerging markets. Intensifying solvency concerns have led to emergency resolutions of major US and European financial institutions and unprecedented government measures aimed at stabilising markets. These have included massive liquidity provision, extensions of deposit insurance, and purchasing shares and troubled assets from banks with public funds.

In addition to the financial crisis, surging food and fuel prices and tightening capacity constraints have propelled inflation to rates not seen in a decade. However, as a result of the global downturn and a significant drop in the price of crude oil (from previous record highs), in the latter part of 2008, there has been a reduction in this inflationary pressure. In developing economies, consumer price rises have been particularly strong, reflecting the high price of food in consumption markets, still relatively high-growth, and less-well-anchored inflation expectations.

The recent slump follows sustained expansion built on the increasing integration of emerging and developing economies into the global economy. In hindsight, however, lax economic and regulatory policies may have allowed unsustainable growth, and may have contributed to a build-up in imbalances across financial, housing, and commodity markets. At the same time, market flaws, together with policy shortcomings, have allowed market stresses to build over the last decade.

IMF forecasts have recently been downgraded to take in to account the worsening climate. The forecasts show that, on an annual basis, global growth is expected to moderate from 5.0 percent in 2007 to 3.9 percent in 2008 and then 3.0 percent in 2009. This would be the slowest growth since 2002. Advanced economies would be in, or close to, recession in the second half of 2008 and early 2009, with recovery anticipated later in 2009.

The October 2008 *Global Financial Stability Report*[3] outlines several factors that are expected to lay the foundations for this recovery. Commodity prices are predicted to stabilise, albeit at 20-year highs, a recovery is expected in the US housing sector and strong productivity growth from the emerging economies will continue.

However, the IMF baseline forecast is founded on the assumption that market liquidity is gradually restored. This is by no means certain. Counterpart risks are likely to remain at very high levels for some time. Several other risks could also have an impact on the global outlook, in particular two related financial concerns: that financial stress could remain very high and that credit constraints from de-leveraging could be deeper and more protracted than envisaged.

Additionally, housing market deteriorations in both the US and Europe could prove deeper and more prolonged than previously anticipated. As this report is compiled, the future is by no means clear.

Figure 1.1: World outlook. percentage change in economic output, 2005 to 2009

	Estimate		Forecast	
	2006 %p.a.	**2007 %p.a.**	**2008 %p.a.**	**2009 %p.a.**
World (in PPP weights)[4]	**5.1**	**5.0**	**3.9**	**3.0**
- World	**3.9**	**3.7**	**2.7**	**1.9**
High-income countries	**3.0**	**2.6**	**1.5**	**0.5**
- Euro Area	2.8	2.6	1.3	0.2
- UK *(HM Treasury indep.)*	**2.8**	**3.0**	**1.0** *(1.1)*	**-0.1** *(0.3)*
- Japan	2.4	2.1	0.7	0.5
- U.S.A.	2.8	2.0	1.6	0.1
Developing countries	**7.9**	**8.0**	**6.9**	**6.1**
- Brazil	3.8	5.4	5.2	3.5
- Russian Federation	7.4	8.1	7.0	5.5
- India	9.8	9.3	7.9	6.9
- China	11.6	11.9	9.7	9.3
- Africa	6.1	6.3	5.9	6.0

Source: IMF 2008, HM Treasury Average from independent forecasts September 2008

1.2 The 'Eurozone' economies

Real GDP growth has stalled in the eurozone in 2008, following a first-quarter rebound, and indicators now suggest that many countries are moving close to or into recession.

Economic growth is being slowed by a number of factors, initially by rising oil prices but now increasingly by tightening financial conditions and the international liquidity crisis. European banks have struggled with their exposure to losses on their holdings of US mortgage-related assets and deteriorating overall credit quality since 2007. Concerns that initially focused on liquidity are also affecting solvency, with leveraged banks now struggling to maintain funding in the face of rising creditor concerns about balance-sheet risk. The process of deleveraging[5], including market exit by some institutions, will likely be long and arduous and banks have already tightened lending standards to far above pre-turmoil levels.

However, even in the absence of a full and outright credit crunch, the significant downturn in residential real estate will have an appreciable short-run impact in some countries (for example, Ireland, Spain, and the UK) and, with the exception of a few countries (for example, Austria, Germany, and Switzerland), produce noticeable medium term challenges. Households and firms operating in real estate are struggling under growing debt burdens, particularly in Ireland, Spain, and the UK, where floating-rate mortgages indexed to short-term interest rates are common.

Furthermore, following a prolonged economic expansion, a significant slowdown is appearing in the emerging European economies. Despite the ongoing expansion of productive capacity and rapid lending to the private sector by mostly foreign banks (particularly in Bulgaria and Romania), prospects for continued strong capital inflows have weakened noticeably. The Baltic economies, notably Estonia and Latvia, are already undergoing sharp corrections as large domestic and external imbalances, that had accumulated during drawn-out consumption and investment booms, are starting to unwind.

Although euro area balance sheets are stronger than at the onset of the 2001 to 2002 cyclical downturn, the longer the financial stresses last, the more corporate profits, balance sheets, and investment will suffer. The euro area's external current account was close to balance in 2007, however exports are expected to slow in line with world demand in 2008/09, and the current account is expected to deteriorate, mainly on account of worsened terms of trade. The UK's current account is in noticeable deficit, and the pound sterling has depreciated by more than 10 percent in real effective terms since the onset of the market turmoil at the start of 2008.

In this challenging environment, central banks have tried to ease liquidity pressures, including through provision of US dollar liquidity, and a number of governments (for example, Belgium, France, Germany, Luxembourg, the Netherlands, and the UK) have stepped in to provide solvency support for resolutions of a number of major banks.

Baseline projections envisage a significant slowdown in activity across Europe followed by a very gradual recovery beginning in the second half of 2009. Euro area growth is expected to moderate from 2.6 percent in 2007 to 1.3 percent and 0.2 percent, respectively, in 2008 to 2009, before returning to 1.4 percent in 2010. These projections see headline inflation falling below 2 percent in the euro area by the end of 2009, but the immediate priority for central banks is to maintain calm in financial markets by continuing to provide liquidity as needed. It must be noted that the risks around these growth projections are to the downside, and include accelerated deleveraging in the financial sector set off by broader asset price deflation and a global credit crunch, an abrupt unwinding of global imbalances, and sharp appreciation of the euro. Volatile energy and food prices present a source of two-way risk, although oil prices have been falling considerably in the latter part of 2008.

The continuing financial turmoil presents important policy challenges on various fronts, including because of complex cross-border financial linkages and spillovers. The latter is a particular concern for EU countries, given their quest to build a single market in financial services. **Restoring confidence will require a decisive commitment to concerted and coordinated action to alleviate financial stresses and avoid the serious risk of backtracking on European financial integration.**

Figure 1.2: Euro area economies. Real GDP, consumer prices and ILO Unemployment, 2006 to 2009[6]
(Annual percentage change and percent of the labour force)

	Real GDP				Consumer Prices				ILO Unemployment			
	2006	2007	2008	2009	2006	2007	2008	2009	2006	2007	2008	2009
United States	*2.8*	*2.0*	*1.6*	*0.1*	*3.2*	*2.9*	*4.2*	*1.8*	*4.6*	*4.6*	*5.6*	*6.9*
Euro Area	**2.8**	**2.6**	**1.3**	**0.2**	**2.2**	**2.1**	**3.5**	**1.9**	**8.7**	**7.4**	**7.6**	**8.3**
UK	2.8	3.0	1.0	-0.1	2.3	2.3	3.8	2.9	5.4	5.4	5.4	6.0
Germany	3.0	2.5	1.8	0.0	1.8	2.3	2.9	1.4	9.8	8.4	7.4	8.0
France	2.2	2.2	0.8	0.2	1.9	1.6	3.4	1.6	9.2	8.3	7.7	8.3
Italy	1.8	1.5	-0.1	-0.2	2.2	2.0	3.4	1.9	6.8	6.2	6.7	6.6
Spain	3.9	3.7	1.4	-0.2	3.6	2.8	4.5	2.6	8.5	8.3	11.2	14.7
Netherlands	3.4	3.5	2.3	1.0	1.7	2.2	3.5	2.3	4.8	4.4	4.2	4.4
Belgium	2.9	2.8	1.4	0.2	2.3	2.8	4.6	2.8	8.3	7.5	7.1	8.6
Austria	3.4	3.1	2.0	0.8	1.7	2.2	3.5	2.3	4.8	4.4	4.2	4.4
Finland	4.9	4.5	2.5	1.6	1.3	1.6	3.9	2.5	7.7	6.8	6.2	6.2
Greece	4.2	4.0	3.2	2.0	3.3	3.0	4.4	3.1	8.9	8.3	7.7	8.3
Portugal	1.4	1.9	0.6	0.1	3.0	2.4	3.2	2.0	7.7	8.0	7.6	7.8
Ireland	5.7	6.0	-1.8	-0.6	2.7	2.9	3.5	2.4	4.4	4.5	5.7	7.0
Luxembourg	6.1	4.5	2.3	1.8	2.7	2.3	3.7	1.8	4.4	4.4	4.4	4.8
Slovenia	5.7	6.1	4.3	3.7	2.5	3.6	5.9	3.3	5.9	4.8	4.8	5.0
Cyprus	4.0	4.4	3.4	2.8	2.2	2.2	4.6	3.5	4.6	3.9	3.9	3.9
Malta	3.1	3.7	2.8	2.3	2.6	0.7	3.7	2.2	7.3	6.4	6.5	7.0

Source: IMF 2008, HM Treasury Average from independent forecasts September 2008

1.3 The UK's current economic performance

After the longest period of uninterrupted economic growth in modern British history – a decade of price stability, rapidly rising living standards and low unemployment – **a significant slowdown is emerging not only in the UK services sector, but also in both consumer spending and UK business investment**.

The economic slowdown and the effects of higher interest rates, as well as unusually large increases in energy, fuel and food prices, have seen the UK economy slow throughout 2008. Forecasts suggest this will continue into 2009. **Following strong growth in 2007, averaging around 3.0percent**[7], **current independent forecasts for 2008 are considerably lower, averaging around 1.0 percent.**

The credit crunch and the weakening of the American and European economies are much more severe than previously thought and an outright recession is now likely, if not already a reality. After the UK economy ground to a halt in quarter 3 of 2008 (0.0% growth), it is likely we will see a further contraction of growth in quarter 4, resulting in a technical recession.

Savings ratios continue to fall to record lows, increasing exposure to interest rate rises. Rates remained steady at 5.0 percent for a large part of 2008 as the Bank of England struggled to deal with a slowing economy and soaring inflation. However, the interest rate was reduced to 4.5 percent in October 2008 and is likely to fall further in 2009. Indeed, there is the possibility that in the medium term inflation may sharply decrease to below 2 percent as spare capacity increases and the upward inflation from energy, food and import prices diminishes[8].

Although the UK's unemployment rate has increased in the last one to two years, and more notably in latter part of 2008, it is still relatively low in comparison to other European countries, at around 5.3 percent of the economically active population (ILO unemployment[9]). Earnings growth has remained moderate[10], despite the concerns that high inflation might push up wage inflation. This has been helped, at least in the short term, by strong inward migration helping to ease skill shortages.

UK housing market activity is significantly down and house price inflation eased from the latter part of 2007 and in to 2008. Mortgage lending collapsed in August 2008, as banks and building societies lent only £143m: 5 percent of July's figure and only 2 percent of lending in August 2007.[11]

Data from the UK building society Nationwide indicated that house prices are 12.4 percent lower than September 2007. **House prices and housing sales are expected to fall further still, before any potential recovery in the market begins in late 2009 or even 2010.** Indeed, it is estimated that prices may fall as much as 30 percent from their 2007 peak, taking values back to 2003 levels, before any recovery in late 2009 / early 2010[12].

Forecast growth

The UK is particularly vulnerable to the impact of the credit crunch, given the importance of the financial sector to the broader economy, with Banking and Financial Services accounting for around 6.5 percent of GVA, compared with an average of 4 to 5 percent in other European countries. Significantly, the parts of the sector which have grown fastest – such as hedge funds and wholesale finance – are among those which are currently undergoing traumatic structural shifts. **The increasing volatility within the financial markets is likely to have negative implications beyond the sector and will impact across associated business and professional services**.

Forecasts for the UK indicate that economic growth will slow from around 1.2 percent in 2008 to a much lower 0.5 percent in 2009 (private sector consensus forecasts), reflecting opinion surrounding the deteriorating economic conditions. **Financial market conditions are likely to continue to affect UK demand and inflation,** through the price and availability of credit, asset prices and increased global uncertainty. Stricter lending criteria, will put further pressure on household consumption, as well as acting negatively on business investment.

Figure 1.3: Summary of Economic Prospects, United Kingdom 2008 to 2009

Indicator	HM Treasury forecasts % in year growth (September 2008)		Independent forecasts % in year growth (September 2008)	
	2008	2009	2008	2009
GDP	1.75 to 2.25	2.25 to 2.75	1.2	0.5
Consumer Spending	1.25 to 1.75	2.0 to 2.5	1.8	0.0
Investment	1.75 to 2.25	2.75 to 3.25	-2.3	-2.1

Source: HM Treasury, 2008

Inflation

As predicted by the Bank of England[13], inflation rose considerably above the 2 percent target in 2008 reflecting the impact of higher energy prices and the depreciation of the sterling. However, **there remains considerable uncertainty regarding inflation projections in to 2009 and beyond**. Despite interest rate cuts in the latter part of the year, households have been facing a growing stock of debt. **Furthermore, the housing market has slowed considerably which is affecting consumer confidence and** this could result in a decline in personal savings (wealth effect) as well as the reduction in collaterals.

The recent market turmoil suggests a turning point has been reached. The housing market has combined with banking and financial problems to form a self-reinforcing downward spiral in asset prices, confidence, spending and growth. The weakening of US growth prospects is now directly affecting the UK economy, and the euro area, which is the UK's bigger trading partner.

Although price rises have recently begun to ease, any significant increase in the cost of oil in the next year or so may threaten growth by fuelling inflationary pressures, as other global commodity and food prices also rise. **Economic growth in the UK during 2008 and beyond could be severely curtailed if inflation rises to an extent where interest rates cannot be cut**. However, with possible spare capacity and lower import prices, along with pressure from Government, it is likely rates may be cut further before 2009, as inflation worries ease.

Trade and Sterling

Recent performance in the money markets shows that sterling has weakened considerably, especially against the euro in recent months. The pound fell to £1.25 per euro in early September 2008, **its lowest level since the single currency was introduced in 1999**[14]. Over half of UK exports are destined for the Eurozone, **so the new rate should provide a potential boost to manufacturers, helping mitigate the impact of slowing demand at home**. Although the Eurozone economies are not without their problems: the economies of France and Germany, along with all 15 Eurozone members, contracted between April and June 2008. France and Germany are the UK's key continental trade partners receiving over 20 percent of UK exports[15].

The pound has also lost ground against the dollar. This may prove less beneficial, as a strong sterling/dollar exchange rate has helped to take the edge off high commodity prices (as most commodities are priced in dollars). Moreover**, with the US economy slowing sharply, this suggests that UK manufacturers will find it much more difficult to expand their sales in the American market, even with a weaker pound.**

1.3 The UK's long-term economic outlook – drivers of change

In November 2006, the Treasury published a report called 'Long-term opportunities and challenges for the UK: Analysis for the 2007 Comprehensive Spending Review'[16], highlighting five challenges for UK growth:

- **Demographic and socio-economic change** - meeting the challenges of an ageing population and the associated rising consumer expectations of public services;
- **Globalisation** - the balance of international economic activity is currently shifting towards the emerging markets of both China and India, which implies an increase in cross-border competition;
- **Innovation and technological diffusion** - the pace of innovation and technological diffusion is a key driver of productivity in the economy and hence, bear an important role in the creation of more competitive markets;
- **Increasing pressures on natural resources and global climate** - as the cost of carbon rises in response to tighter climate change mitigation policies, further industrial restructuring will be required. This will be particularly relevant to the UK economy, where some of the northern regions are still relatively specialised in some carbon intensive industrial sectors (e.g. Textiles, Chemicals, Glass Manufacture, Air Transport)[17]; and
- **Continued global uncertainty** - addressing the ongoing threats of international terrorism and global conflict.

Population

The UK is predicted to experience significant demographic change over the next ten years and beyond. The country will see both a general increase in population, supported by migration, and an increase in the proportion of individuals aged 65 years old and over. **Population increases across the UK will also be subject to significant regional variations,** with the South East, London, the East, and the South West projected to experience significantly large increases in population.

Government projections also include assumptions about future trends in internal migration, where the East, South East and South West are predicted to witness a net internal (within UK) inflow between now and 2017. By contrast, it is assumed that **London and the Northwest will observe a net internal outflow over the next decade (migration out of London tends to be to locations within the wider Greater South East)**.

Other trends include an increase in the numbers of women and older people entering the labour market and a rise in average incomes that is expected to lead to more demanding consumers, especially with public services.

Globalisation

The global economy is evolving to accommodate shifting trading patterns, the rise of new sources of economic growth and advances in technology. These changes have been partly caused by the significant economic growth of formerly developing countries. **The Treasury has predicted that by 2017, China and India will have nearly doubled their share of world income** with economies bigger than the UK, France and Germany combined. This increasingly competitive global environment, presents the UK with the following challenges:

- the shifting balance of global economic activity;
- greater competition for investment flows;
- increasing international specialisation;
- greater rewards from innovation;
- higher levels of demand for skills; and
- growing pressure on energy resources and the environment.

In order to remain in a globally strong economic position, the UK will need to further enhance the sectors where it holds a comparative advantage, for example sub-sectors of the science and engineering industry, and financial services. In association with this, it will be vital to increase the cultivation of a highly qualified workforce that embraces innovation.

Technological change

Technological change is a key driver of economic growth and productivity. Government's Department for Innovation, Universities and Skills (DIUS) has identified the eight clusters of technological development that are most important for the UK[18]:

- **Information and knowledge management** – refining and streamlining the handling of data, information and knowledge, to increase the speed and accuracy of processes in a wide range of areas, from government to finance and engineering;
- **Sensors and tracking** – improving the monitoring, modelling and management of various systems, such as natural hazards, space and weather systems and the movement of goods and people;
- **Network interactions and communications** - such as those between mobile phone networks and the internet have the potential to impact on many areas of life, from the nature and capacity of early warning systems to the design of organisations;
- **New security technologies** - will have benefits and implications for homes and businesses, supporting government policies aimed at crime, defence and counter-terrorism;
- **Advanced materials** – in the future new 'smart' materials will be able to respond to changing conditions, indicating when repairs are required or even being able to self-repair and self-clean;
- **Nanotechnologies** - manipulate materials at a molecular level to give them enhanced properties, for example making them harder, tougher, self-healing or lighter. Nanotechnologies could enable better diagnosis and treatment of diseases, faster and more efficient computing and cleaner energy sources;
- **Mind and body sciences** - hold the potential for new and better medical treatments based on a greater understanding of how the human mind and body function; and
- **New energy technologies** - are expected over the next decade in response to the challenges of climate change, diminishing coal and oil reserves and increasing global energy requirements resulting from population growth.

These eight clusters highlight the need for the UK to prioritise its production and delivery of higher value added products and services. This means encouraging technological development in the fields of transport, education, security, health and energy.

Climate and environmental change

Climate change and the control of carbon emissions are defining a new legislative and policy agenda internationally and nationally. Whilst the effects are not yet fully defined, there is now clear national and international momentum towards substantive economic intervention to control emissions of Greenhouse gasses (GHG's) and increasing adaptation to unavoidable climate change. The 2008 'Mini-Stern' for Manchester[19] concluded that **whilst climate change represents a significant threat to the City Region's economic growth in future years, it is also clear that the agenda could create significant economic opportunity to the City Region if it takes early action.** The challenges include creating the right conditions for new businesses in the emerging environmental technology sector and ensuring existing businesses have the right support and expertise to enable them to adapt quickly to changing market conditions and trends.

1.4 The Northwest economy

The Northwest economy is built on 233,000 workplaces, employing over three million people[20]. **It contributes around £100 billion to total UK GVA: an estimated 10 percent of total national output.** It has a population of over 6.8 million and almost 63 percent are of working age[21]. **An estimated 70 percent of the working age resident population are in the workforce, being either in employment or self-employed**.

Claimant Count unemployment in the Northwest stands at 3.0 percent of the working age population (September 2008) and is currently higher than the UK average (2.5%)[22]. Although Claimant Count rates in both regional and national terms have been increasing over 2008 (the Northwest working age rate is currently at its highest level since January 2007), unemployment is still historically low compared to the 1990's and early 2000.

Despite the decline in the Northwest's population during the 1990s, the rate of growth in the number of jobs remained broadly similar to that of the UK. However, **since 2000, the rate has been significantly higher,** an average of around 0.4 percent per annum, **resulting in an additional +221,000 employees in the Northwest's economy between 1999 and 2004** [23].

The pace of growth of the Northwest's economic output at the beginning of the decade has resulted in the narrowing of the GVA 'growth rate gap' which exists between the Northwest and the UK average - **falling by an average of 0.1 percent a year between 2000 and 2005.** However the actual level of resident productivity, expressed as the GVA per resident capita (£14,700), still shows a persistent gap with the UK average (£16,700). **This regional figure has remained at around 12 to 13 percent lower than the UK average over the last decade – equivalent to an estimated output gap of £13 billion per year**[24]**.**

Recent research has attempted to explain this gap, in terms of the following three important influences:[25]

- **the differences in labour markets**, mainly the participation of men, but also less 'double jobbing', and fewer hours worked in the Northwest;
- **differences in price levels** affecting acceptable earnings in different parts of the country (research also suggests that relative prices of goods and services have also been falling in the Northwest, but rising in the South East, and especially in London); and
- **differences in the proportion of jobs in various levels of occupations** in the Northwest as against the UK, and especially as against the Greater South East: influenced by the success of London.

Analysis of workplace based GVA data suggests the issue is even more acute. **GVA per head in employment in the region's workplaces**[26]**, show that productivity levels have been falling relative to the UK over the last decade.** GVA per employment in the Northwest (£29,400) currently stands at 90 percent of the UK average[27] (£32,800)[28]. Ten years ago the Northwest and the UK both had significantly more of their employees in manufacturing, and **there is evidence that the loss of manufacturing jobs has been faster in the Northwest, which has quickly eroded what was a productivity advantage compared to the wider country**.

Another key factor is that a significant number of new jobs in the Northwest, (since 2000) have been lower value added, back office and ancillary jobs, e.g. call-centres (many of which had moved out of higher cost locations in the South of England). Whereas **higher value added service sector jobs have become increasingly concentrated in and around London,** especially jobs with national and international clients. **The overall effect (in the short term) has been a downward pressure on regional productivity levels, particularly within key sectors such as Financial and Professional Services and Other Business Services sectors**.

Differences in the Northwest's productivity are also influenced by the supply side of the economy. **Whilst levels of participation and achievement in learning across the region have been rising relative to the UK, the proportion of residents with higher level qualifications (Level 4+) still remains behind the UK average** - **lagging significantly behind the better performing regions,** such as London and the Greater South East.

It is important to note that GVA comparisons do not fully reflect differences in regional price levels that also affect living standards and other aspects of the quality of life, or the comparative advantage that lower prices / wages may offer a region. For example, about a third of the gap in GVA between the Northwest and the UK in 2004 (around 12.5%) can be explained by the fact that employees in the Northwest earn less for similar kinds of work,[29] interpreted as a reflection of the influence of its lower general price level on wage settlements, a price level that has been falling relative to the UK.

Although this may highlight the difficulty of using GVA figures in such comparisons, gaps in GVA per head are still widely accepted as prima facie evidence of differences in the capability of regional economies to generate satisfactory incomes for their residents, and this indicator has become the government's headline target measure of regional performance.

Whilst the GVA gap has clearly disadvantaged the region in the past, it also means that with the right focus on skills, there is still considerable potential for the Northwest to grow, especially in and around its major towns and cities. This, in addition to encouraging the forces of 'economic agglomeration', could have a significant impact on raising productivity in the long-term.

1.5 The Manchester City Region economy

The Manchester City Region is now the main driver of the Northwest economy. It is home to a population of over three million residents (47% of the Northwest total), of whom 64 percent are of working age[30]. 71 percent of these are either in employment or self-employed. Claimant count unemployment in the MCR stands at 2.8 percent of the working age population (September 2008), which remains marginally above the UK rate (2.5%), but below the Northwest (3.0%)[31].

The City Region generates 50 percent of the Northwest's total GVA (of which GM makes up 39%), and with a GVA output of £50 billion in 2004 (forecast at £54bn in 2007), it is the largest city-regional economy outside London[32], contributing 5.0 percent of the total national GVA output. **As an international centre for knowledge intensive activity and private sector driven growth, Manchester, makes a unique contribution to the wider North**.

During the 1980s and early 1990s, economic output had fallen in real terms in most of MCR, reflecting the restructuring of the economy, as well as the effects of the 1987 UK recession and the global slowdown between 1990 and 1991, which had a particular impact on the Northwest, **MCR turned a corner around 1995 and economic growth has now outstripped the Northwest average for the last decade**. During the same period **almost 90 percent of the net increase in the Northwest's population, and almost half (48%) the net increase in the Northwest's employment, were related to MCR's growth**.

GVA and job growth in the City Region has been driven by a number of key industry sectors that have helped **MCR develop as a major centre of knowledge intensive industries**. These include sectors such as Financial and Professional Services, Life Sciences, ICT / Digital Communications, Creative / Digital / New Media, as well as established sectors such as Logistics and Construction. Employment levels have also grown significantly. The City Region enjoyed particularly strong growth between 1999 and 2004, represented by a net in year increase in employment of +75,900 jobs over the period, driven primarily by traded service sector jobs.

However **despite significant growth over the last decade, the annual GVA growth rates between 1999 and 2004 in MCR (2.4%) and GM (2.5%) were lower than the UK (2.9%)**, even when London is excluded. MCR, **resident productivity levels also remain lower than the national average**, with a GVA per resident of £15,800 in 2004 comparing to a UK figure of £16,700[33]. Although, in this case it is higher than the national figure if London is excluded (£15,500).

Workforce productivity in MCR workplaces (expressed as GVA per employment), currently stands at £30,600, which also falls some way behind the UK average of £32,800, but is again closer to the UK average excluding Greater London (£31,200).

Figure 1.4: Population, GVA, Productivity, and Employment, GM, MCR, NW, and UK, 1999 to 2004

	GM		MCR		NW		UK	
	2004 level	change 99-04 %p.a.	2004 level	change 99-04 %p.a.	2004 level	change 99-04 %p.a.	2004 level	change 99-04 %p.a.
Population	2,533,600	+0.1	3,183,500	+0.2	6,819,600	+0.1	59,835,000	+0.4
Working age population	1,620,000	+0.6	2,030,000	+0.6	4,290,000	+0.5	37,900,000	+0.6
Residents in employment	1,130,000	+1.1	1,440,000	+1.0	3,010,000	+1.2	-	-
GVA (£billions)	£39.5bn	+2.5	£50.5bn	+2.4	£100.1bn	+2.5	£999.1bn	+2.9
Employees	1,170,000	+1.2	1,460,000	+0.9	2,991,800	+1.3	26,343,000	+1.0
Total Employment*	1,319,800	+1.3	1,651,500	+0.9	3,401,200	+1.4	30,514,100	+1.0
Workplace Earnings	£392.90	+3.5	-	-	£394.10	+3.7	£419.20	+3.9
GVA per resident	£15,600	+2.4	£15,800	+2.2	£14,700	+2.4	£16,700	+2.5
GVA per employment	£29,900	+1.2	£30,600	+1.4	£29,400	+1.1	£32,800	+1.8
GVA (£billions) (UK excluding Greater London)							£810bn	+2.9
GVA per resident (UK excluding Greater London)							£15,500	+2.5
GVA per employee (UK excluding Greater London)							£31,200	+1.7

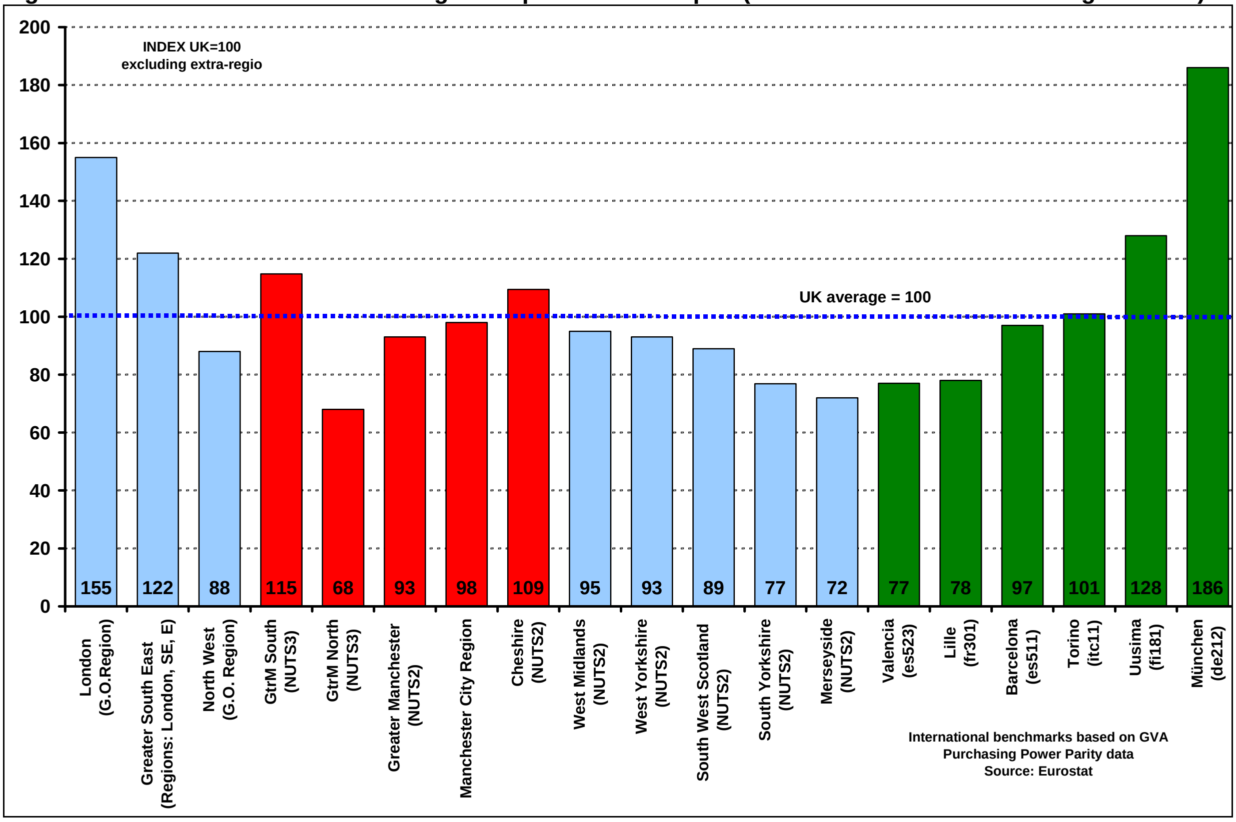
Source: Greater Manchester Forecasting Model, Spring 2007;
Median earnings data not available for MCR;
**Total Employment = Employees plus Self Employed and takes account of double jobbing.*

1.6 Benchmarking

As part of the baseline analysis, the MCR economy was benchmarked with a number of comparator UK and EU City Region economies. **Gross Value Added per capita in the Manchester City Region exceeded that for national benchmarks in 2004** (latest comparable actual data across the EU), such as West Yorkshire (Leeds and Bradford Cities), West Midlands (Birmingham City) and South Western Scotland (Glasgow City), as well as GVA per capita in many international destinations such as Lille (Northern France) and Barcelona (North East Spain). However, MCR did not meet the levels of GVA per capita achieved by aspirational benchmarks such as London, Uusima (South East Finland) andMűnchen (Southern Germany).

Figure 1.5 shows that although GVA per head of resident population for MCR is a little behind the UK average, **certain parts of the City Region, namely GM South and Cheshire & Warrington, are operating at levels close to those of London and the South East**. Although , correspondingly, other parts perform notably poorer.

Figure 1.5: Performance benchmarking: GVA per resident capita (Index of 100 for the UK average in 2004)



Source: ONS, GMFM, Eurostat

Looking in more detail at the benchmark city regions, it is clear that the better performing economies, such as London and Műnchen, share a number of common characteristics:

- a greater proportion of high value added sectors;
- higher employment density and '*clustering'* of knowledge sectors;
- scale: larger, dense urban agglomerations outperform smaller – 'peripheral' areas;
- a more significant share of international growth sectors;
- a higher proportion of total GVA output spent on research and development;
- higher levels of entrepreneurship compared with the MCR;
- more significant numbers of international headquarters;
- a higher proportion of the workforce holding graduate or "intermediate" level qualifications i.e. NVQ or equivalent at levels 3 and 4 and above;
- less reliance on public services as a proportion of total GVA output; and
- an efficient and accessible transport system.

It is the intention of local partners to support continued market growth in GM South and Cheshire & Warrington, whilst also seeking to generate additional growth in the North of MCR, so that average productivity rates across the conurbation match those of the UK within a decade. To do this, **action will be needed to reinforce attractiveness and capacity where market demand is currently high, whilst also improving transport infrastructure, skills levels** and the market offer in the less successful areas.

1.7 Recent business performance

In assessing the state of the local economy, it is important to consider the perception of businesses. How do they see the area? How do they see their business performance – now and in future? This will ultimately effect future investment decisions and employment expectations. **Figures 1.6 and 1.7 show information collected from the British Chambers of Commerce (BCC) Quarterly Economic Survey – including respondents from the Greater Manchester Chamber of Commerce**[34] - representing around 5,000 businesses from every region of the country, each year between 2004 and 2008.

UK results: Manufacturing and Service Sectors

The BCC survey at **the end of 2007 signalled a sharp slowdown in UK economic prospects, which has deepened throughout 2008**. Data on trade and business confidence fell for both manufacturing and services in the first part of the year, in some cases to historically low levels. **Export balances also weakened further in the first half of 2008 within the services sector** but rose slightly in manufacturing, partly as a result of the weaker pound.

These negative national results from the BCC survey suggest that the UK economy is set to slow very markedly into 2009, making smaller firms the most vulnerable, with crucial balances such as confidence in profitability continuing to fall rapidly.

Northwest and Greater Manchester[35]: Manufacturing

After solid performances throughout 2007 in the Northwest and Greater Manchester, the manufacturing sector has begun to experience a significant downturn, with some balances at historic lows (regional and sub-regional data consistent back to Q1 2003), **as the effects of the global economic slowdown have started to feed through. Confidence in profitability for Northwest and Greater Manchester exporters has rapidly decreased**.

Businesses have continued to report rising input costs, which is mirrored by a decline in investment intentions. Rising oil costs in particular, have meant that manufacturing firms have been feeling pressure at the margins, although this may not be such a significant pressure going forward.

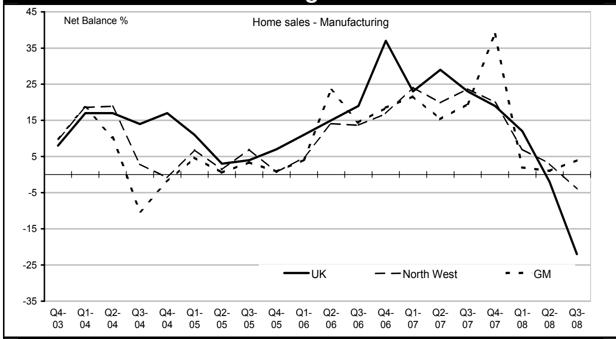
Northwest and Greater Manchester: Services

The service sector witnessed a considerable drop in the number of businesses reporting increasing home sales and orders in the first two quarters of 2008. **There was also a fall in the proportion reporting growth in export sales and orders**.

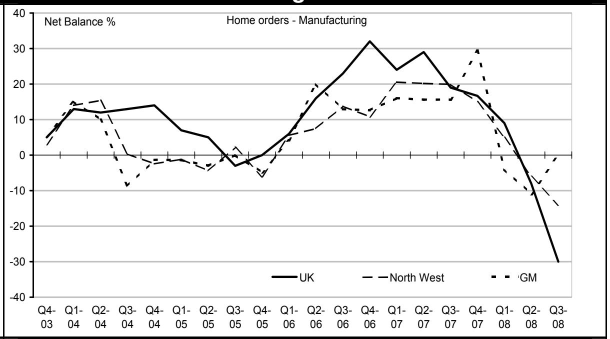
Unsurprisingly, **this has led to falling confidence in profitability and growing expectations that input costs will rise**. In addition, **the economic slowdown is now affecting investment intentions, as firms are less willing to invest in machinery and training, and foresee employment growth to slow further in the latter half of 2008.** There is now a fall in the number of companies reporting an increase in their workforce in 2008 and reduced expectations into 2009.

Figure 1.6: Manufacturing Sector - BCC Quarterly Economic Survey Results, GM, NW, UK 2004 to 2008

Manufacturing: Home sales



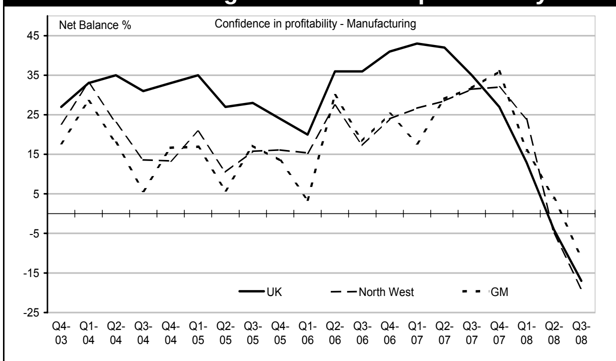
Manufacturing: Home orders



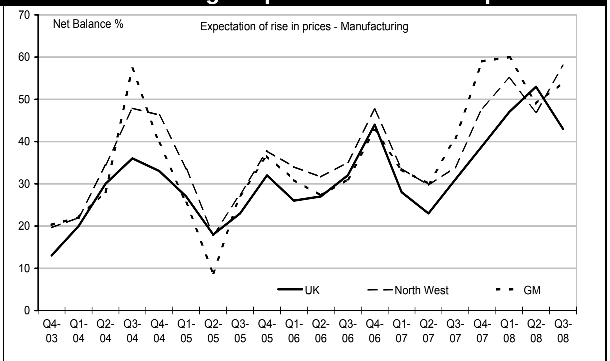
Manufacturing: Export sales

Manufacturing: Export orders

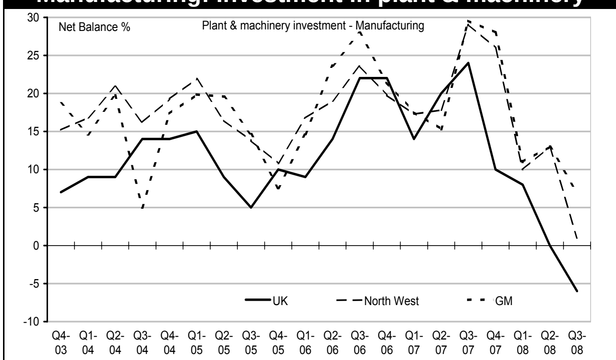
Manufacturing: Confidence in profitability



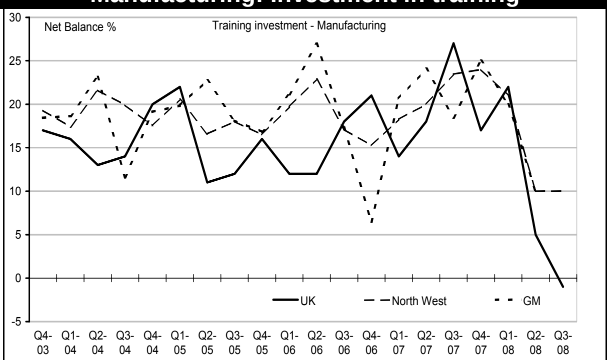
Manufacturing: Expectation of rise in prices



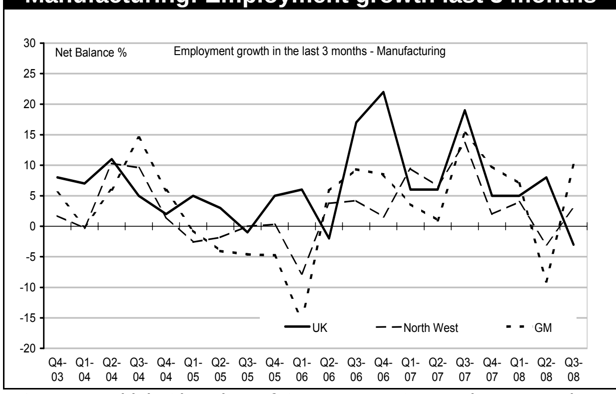
Manufacturing: Investment in plant & machinery



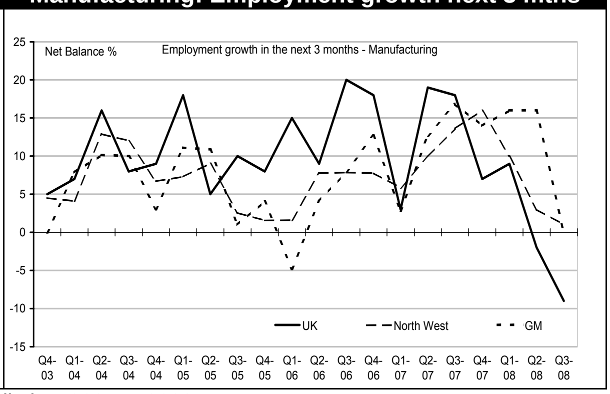
Manufacturing: Investment in training



Manufacturing: Employment growth last 3 months

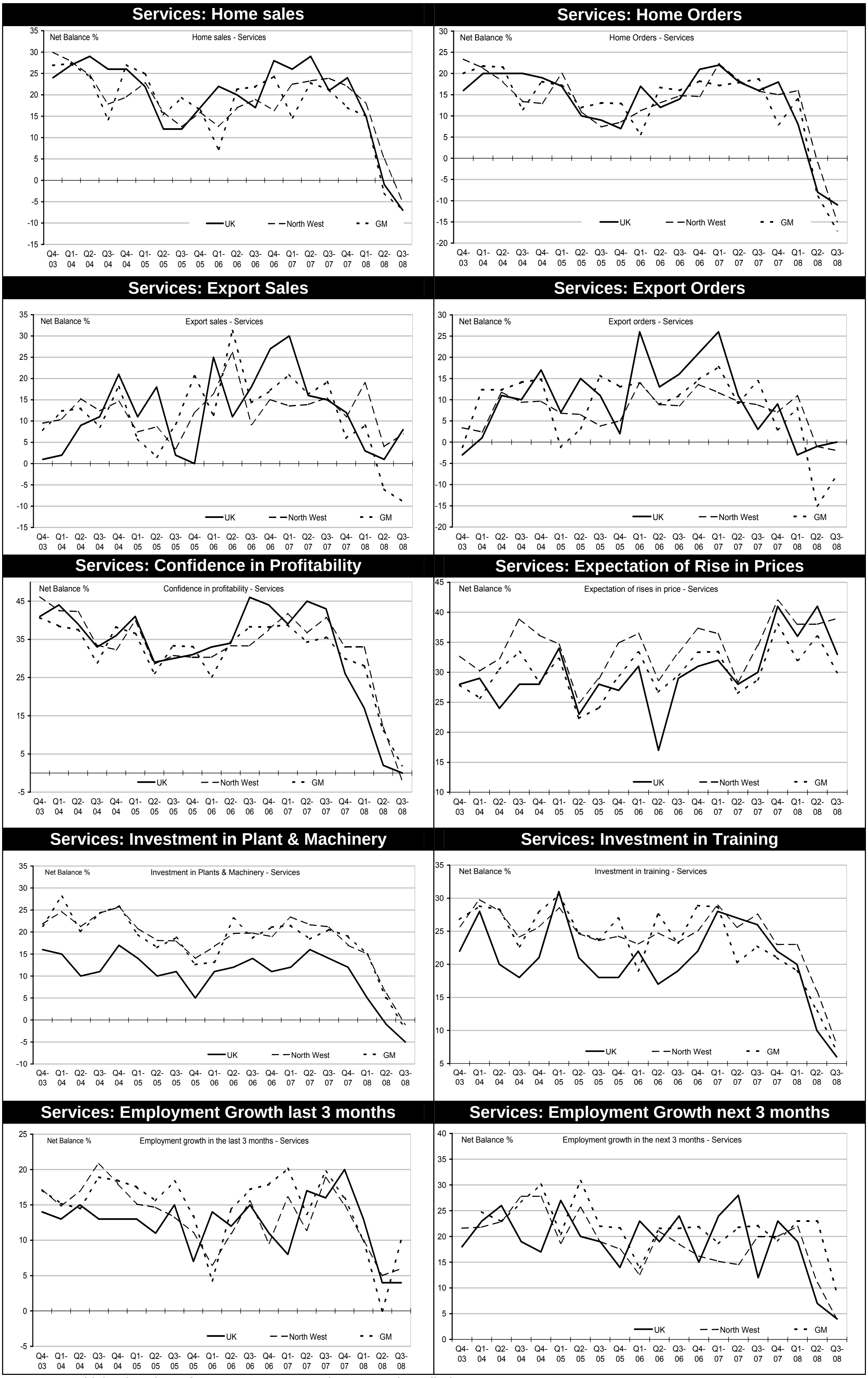


Manufacturing: Employment growth next 3 mths



Source: British Chamber of Commerce, Quarterly Economic Bulletins, 2004 to 2008

Figure 1.7: Service Sector - BCC Quarterly Economic Survey Results, GM, NW, UK 2004 to 2008



Source: British Chamber of Commerce, Quarterly Economic Bulletins, 2004 to 2008

1.8 The future

As part of the growing City Region evidence base**, an econometric model – the Greater Manchester Forecasting Model**[36] **(GMFM) was compiled for the period 1981 to 2026, which sets out the past and potential performance of the Greater Manchester, MCR, Northwest and UK economies**. The forecasts, typically presented for the period 2007 to 2017, are shown in **figure 1.7**. This data should not be interpreted, or presented, as making "hard and fast" predictions, but rather as indicating possible future trends.

Similar to all economic forecasting models, the GMFM **assumes that the existing policy climate will continue relatively unchanged, and that the local economy will follow a similar trend as in the past, with no major shocks** from outside the system.

Figure 1.8 presents GM forecasts for employment, population and GVA for 2007 and 2017, presenting projected figures for 2017 under a "reference" scenario, a "lower growth" scenario and an "accelerated growth" scenario. The reference forecasts show a potential net increase in GVA of +£17.7bn in the GM economy between 2007 and 2017. The forecasts also suggest strong growth in employment and population, with **Greater Manchester making an increasing contribution to the Northwest's economic performance, providing an additional +92,000 new jobs and +122,500 residents coming to GM over the next decade**.

However, serious consideration must now be given to the slowing of the global and UK economy and the possible impact on future scenarios for the City Region's growth. New projections from the GMFM will be released in early 2009, and are expected to be significantly different from initial projections, in light of the economic downturn.

Figures 1.9 to 1.12 show both historic and forecast data for GVA output, employment, population and productivity with the MCR and GM compared with the Northwest and UK averages, using 1987 as a baseline**. These figures highlight the underperformance of GM and to a lesser extent, MCR during the 1980s and early 1990s.** Both employment and output suffered from the 1987 recession and were particularly affected by the global slump of the early 1990s. **These trends are reflected in the steady population decline up to the end of the 1990s, with skilled labour being lost to other regions.** It wasn't until the new century that both employment and population figures were back to the level of the late 1980s.

The end of the 1990s saw exceptional performance within the MCR economy, with growth rates in both employment and GVA exceeding the UK average, and parts of the conurbation matching growth rates within the best performing parts of the UK. **Growth was driven by both a rapidly expanding service sector, particularly within the regional centre**, and significant growth in productivity levels in the manufacturing sector – as restructuring brought higher value added business.

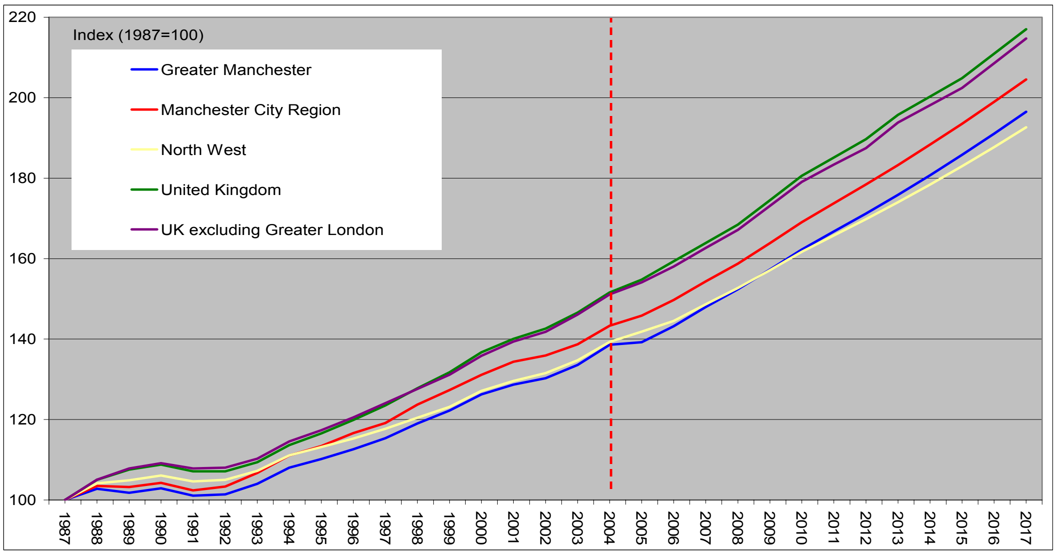
Looking to the long-term future, the MCR economy cannot ignore the constraints and challenges that could threaten growth. There is too great a disparity in the geographical spread of prosperity. The City Region's workforce is its main asset, but disadvantage still falls disproportionately on certain sections of the community. **The baseline will explore these issues in more detail in later chapters, acting as a foundation for the more in depth work of the full Manchester Independent Economic Review**.

Figure 1.8: Headline indicators, historic data and forecasts for Greater Manchester, 2007 to 2017

Greater Manchester	2007	Low Scenario	2017 Reference	High Scenario
Total Employment	1,315,500	-16,500	1,407,700	+99,300
Resident Employment	1,143,100	-34,000	1,209,900	+52,500
Population	2,565,000	0	2,687,500	+23,700
GVA	£42,155bn	-£2,776m	£55,992bn	+£2,747m

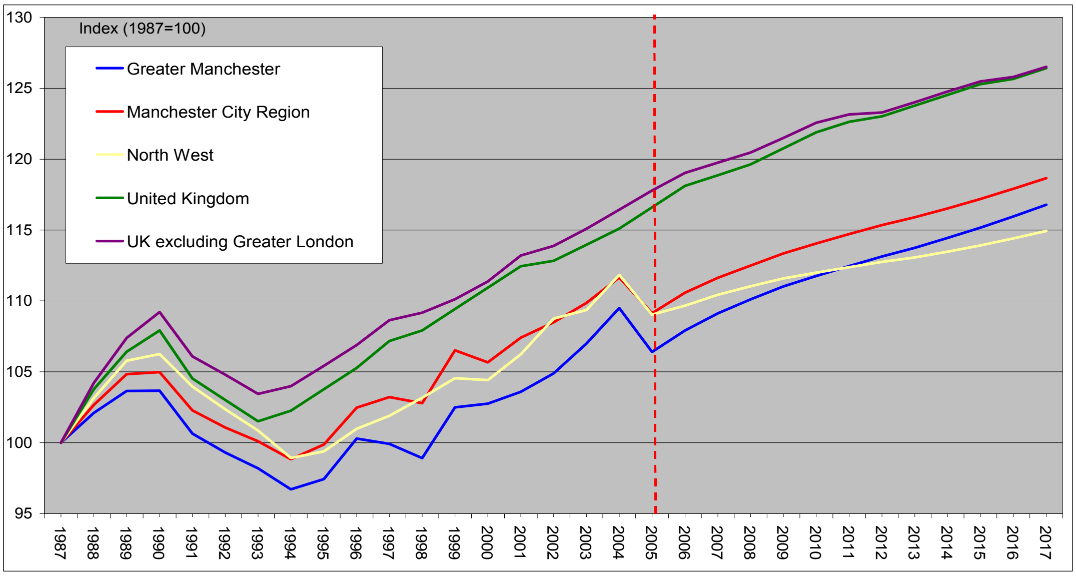
Source: Greater Manchester Forecasting Model, Spring 2007

Figure 1.9: Reference forecast: GVA Output (Index 1987=100), GM, MCR, NW, UK 2007 to 2017



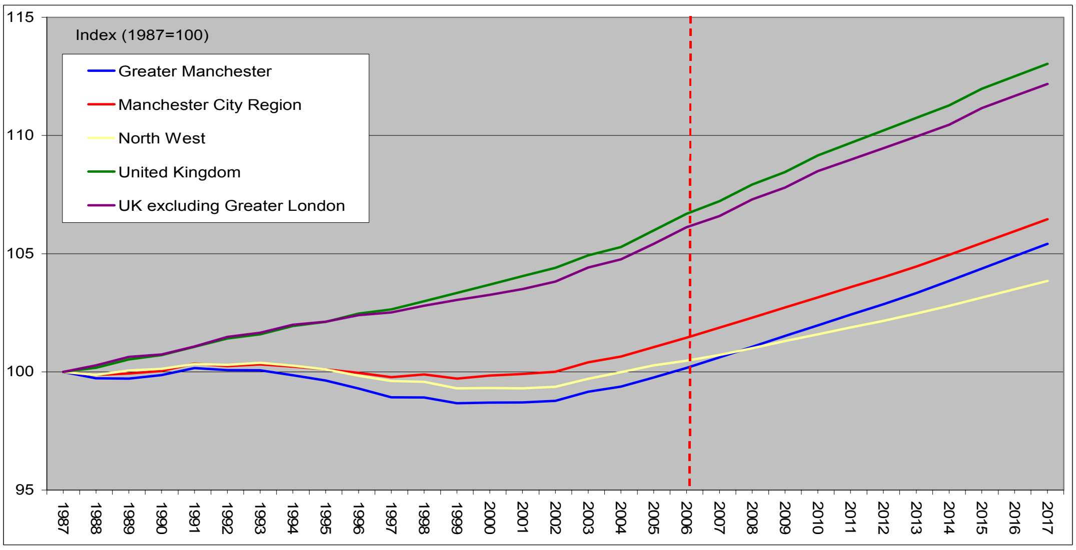
Source: Greater Manchester Forecasting Model, Spring 2007; (Latest actuals GVA: 2004; Employment: 2005; Population 2006)

Figure 1.10: Reference forecast: Total employment (Index 1987=100), GM, MCR, NW, UK 2007 to 2017



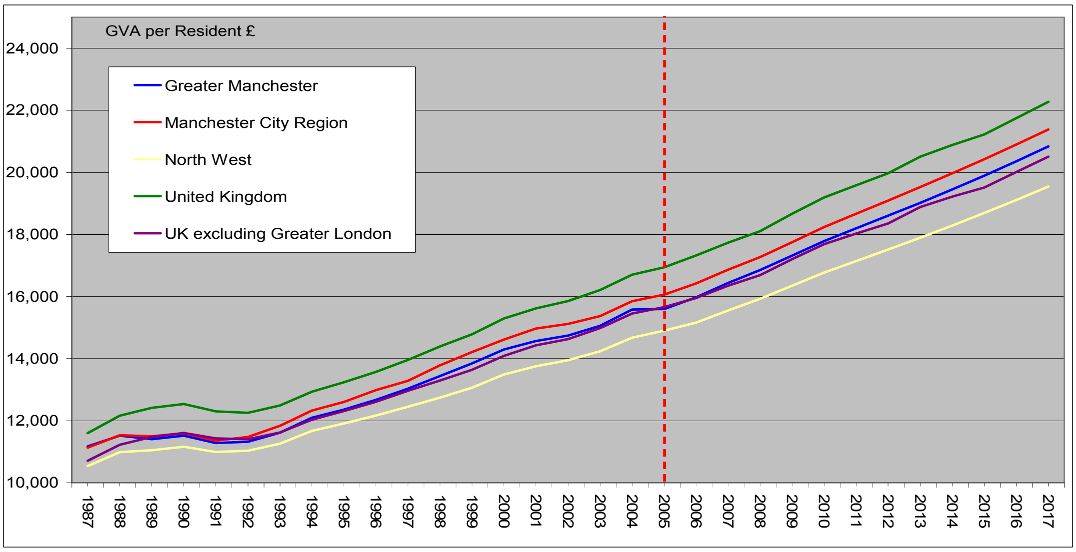
Source: Greater Manchester Forecasting Model, Spring 2007; (Latest actuals GVA: 2004; Employment: 2005; Population 2006)

Figure 1.11: Reference forecast: Total population (Index 1987=100), GM, MCR, NW, UK 2007 to 2017



Source: Greater Manchester Forecasting Model, Spring 2007; (Latest actuals GVA: 2004; Employment: 2005; Population 2006)

Figure 1.12: Reference forecast: GVA per resident (£000's), GM, MCR, NW, UK 2007 to 2017



Source: Greater Manchester Forecasting Model, Spring 2007; (Latest 'actuals GVA: 2004; Employment: 2005; Population 2006)

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[26] *GVA per head in employment within a workplace which is located within the Northwest. This is not the same as data for GVA per resident, which looks at all residents (aged 16 years and above) irrespective of where they work.*

[27] But closer to the UK average when GVA and employment data for Greater London (UK=£31,200) are excluded

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