Economic Brief

September 2003

South East England Development Agency
Policy and Economics Group

In Brief:

- Bank of England leaves interest rates unchanged; the rate is unlikely to rise before early next year.
- The service sector in the region shows signs of strong growth in the second quarter of the year.
- In spite of an increase in export sales manufacturers in the region have had a difficult time in the second quarter of the year.
- The latest labour market picture in the region remains similar to that seen in recent months, healthy if somewhat flat.
- The latest survey data shows that the labour market may be on the upturn in coming months.
- Population in the region increased by 4.95% between 1991 and 2001, the fourth largest increase in England.
- Greater increase in working age population may be needed to sustain the current level of living standard in the future.

BANK OF ENGLAND LEAVES INTEREST RATES UNCHANGED. ARE WE LIKELY TO SEE A RATE RISE BEFORE THE END OF THE YEAR?

At its last Monetary Policy Committee (MPC) meeting in September The Bank of England left the cost of borrowing unchanged at 3.5%, in spite of some signs of stronger economic recovery taking place over the summer (largely fuelled by strong consumer spending). Since the MPC meeting there has been lots of speculation about a possible rise in interest rates in coming months. Several factors have led a number of analysts to predict an increase in the cost of borrowing before the end of the year (some are even suggesting that the rate may even rise at the next meeting in October).

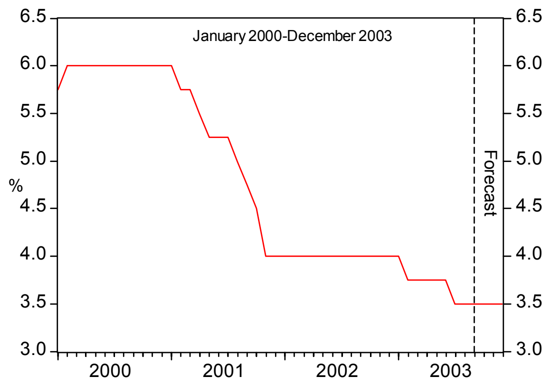
Mortgage lending is at an all-time high after increasing by almost £12 billion in August. This has led to further increase in house prices although at a slower pace than last year. The collapse of the housing market is possibly a single factor that may halt the recovery and even push the economy into a recession. Household debt stands at almost £900 billion equivalent to 124% of annual disposable income. If the trend were to continue, debt will top £1 trillion next summer. Retail sales have picked up and have remained strong despite one of the hottest summer since the record began while inflation remains well above the 2.5% target.

On the other hand there are several factors against the rise of the rates. In spite of some signs of stronger recovery over the summer months growth still remains weak. Manufacturing sector orders have tumbled, while business investment has been falling.

Furthermore, the world economy remains weak in spite of strong recovery in the United States and some signs of long awaited recovery in Japan. This is largely due to a significant under-performance of the Eurozone economy in the first half of the year. Germany, which accounts for almost a third of output of the Euro zone economy was officially in recession in the second quarter, while France, Italy and Holland did not perform much better. In its latest world outlook the IMF slashed its forecast for the Eurozone economy from 1.1% to just 0.5% for 2003, with Germany expected not to grow at all.

Given the state of the business sector in the UK and weak global economy it is more likely that the rates are going to remain unchanged for the rest of the year.

Figure 1: UK nominal interest rates



Source: Bank of England 2003 and SEEDA 2003

Currently the economy is too dependent on the consumer sector and is likely to remain dependent at least until the end of the year. Increase in the cost of borrowing would simply hamper the recovery that is taking place. However as the world economy recovers and as the UK economy becomes more dependant on external rather than internal factors we are likely to see an increase in interest rates early next year.

REGIONAL OVERVIEW

Service Sector

The service sector has showed strong growth in the second quarter of the year.

In the second quarter +20% of firms reported an increase in home sales (up 10 points from the first quarter).[1] Furthermore there was a strong growth in percentage of firms reporting an increase in home orders from +4% in the first quarter to +21% in the second quarter.

[1] Percentage balances determined by subtracting the percentage of companies reporting decreases from the percentage reporting increases.

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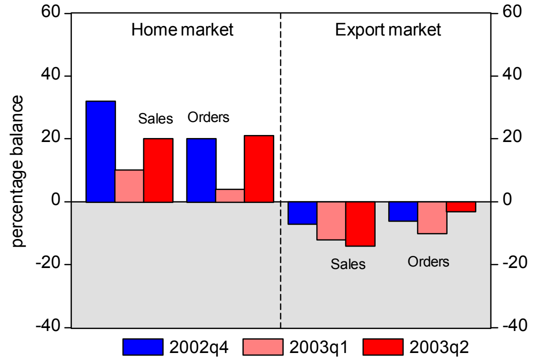
Both home sales and home orders in the region performed better than the national aggregate. The main factor behind the strong performance of the home market has been strong recovery of the consumer sector.

Figure 2: Service sector
South East England



Source: BCC Quarterly Economic Survey 2003

On the other hand export sales performed below the national aggregate, decreasing by 2 points from the first quarter to - 14% of firms in the second quarter. The main factor behind further decline of the export market was likely to be found in poor performance of the global economy and uncertainty associated with the war in Iraq and global economic recovery. Given the structure of the regional service sector economy and its greater dependence on the US and European economies than in some other parts of the country, it was not surprising that the region under performed in relation to the national aggregate.

The export orders market showed some signs of oncoming recovery (performing marginally better than the national aggregate), increasing by 7 points from the previous quarter but still remaining at - 3% of firms.

A relatively strong performance of the service sector in the second quarter has resulted in an increase of firms reporting an improvement in cash flow (up two points from the previous quarter to +8%).

Given the buoyant consumer and public spending and unlikely significant increase in interest rates, which would curb consumer spending over the next year, confidence within the sector remains high with +48% of firms being confident of improving profitability over the next 12 months.

Manufacturing Sector

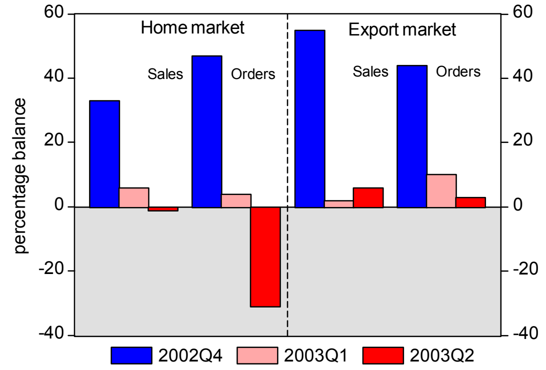
The latest *British Chambers of Commerce (BCC) Quarterly Economic Survey* shows that, in the second quarter of the year the manufacturing sector has had a difficult time in the home market as there was a significant decline in both home sales and home orders.

The percentage of firms reporting an increase in home sales decreased by 7 points to -1%, while there was a 35 point decrease in home orders, from +4% to -31%.
The main factor behind such poor performance of the sector in the home market can be found in the decrease in business investment and relatively poor performance of the UK economy.

Manufacturers in the region have performed slightly better in the export market.

The percentage of firms reporting an increase in export sales increased by 4 points to +6% of firms, while export orders were also positive at +3% in spite of a decline of 7 points.

Figure 2: Manufacturing sector
South East England



Source: BCC Quarterly Economic Survey 2003

Significant depreciation of the pound in the second half of 2002 and the first half of 2003 leading to improvements in competitiveness is probably one of the factors that led to an increase in export sales. Export orders were affected significantly by further decline in economic activity in majority of Eurozone economies.

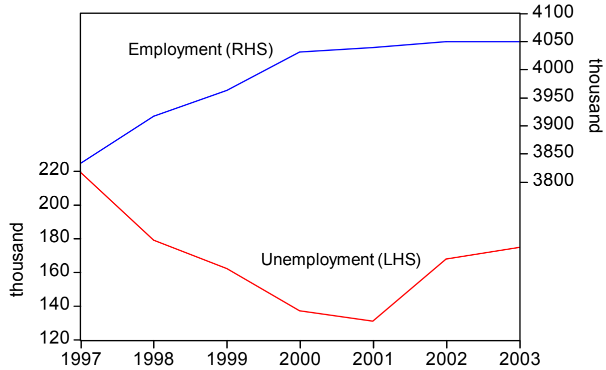
In spite of an increase in the percentage balance of firms reporting an increase in export sales, the cash flow position of manufacturers in the region worsened further. Percentage balance of firms reporting an improvement in cash flow decreased by 5 points to -6%. The main factor behind this was a large decrease in home sales and likely decrease in profit margins from abroad.

However, regardless of the performance of the sector over the first half of the year confidence remains high with +45% of manufacturers being confident of improving profitability over the next 12 months.

Labour Demand

In spite of a poor performance of the economy over the past 12 months and in particular in the first half of the year, the labour market in the region remains rather resilient. The latest labour market picture remains similar to that seen in recent months. Overall the labour market looks healthy if somewhat flat.

Figure 4: South East England
Employment and Unemployment *



Source: ONS 2003
* May - July

In the May to July 2003 period employment in the region stood at 4.05 million, unchanged on the same period last year. The employment rate stood at 79%, while economic activity rate stood at 82.5%.

The seasonally adjusted unemployment increased from 168,000 to 175,000 over the past year.[2] The unemployment rate increased by 0.2% to 4.1% on the same period last year. The headline measure of unemployment (claimant count) also showed a similar picture, increasing by 4,100 between August 2002 and August 2003 to 76,000. The seasonally adjusted claimant count rate increased by 0.1% to 1.8% over the year to August 2003.

Employment prospects for the next three months in the service sector remain positive with +14% of firms expecting their workforce to grow, an increase of 4 points from the first quarter.

In spite of an increase in pessimism regarding employment prospects in manufacturing sector, +14% of manufacturing firms expect to increase their workforce in the next three months. Although this was down 5 points from the first quarter it is still 15 points above the national average.

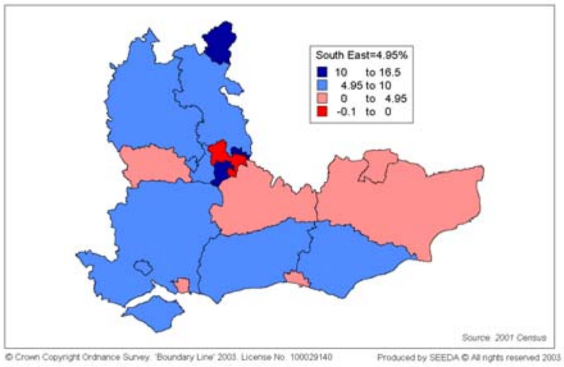
POPULATION IN THE REGION INCREASED BY JUST UNDER FIVE PERCENT TO JUST OVER EIGHT MILLION BETWEEN 1991 AND 2001

The latest 2001 Census data from the Office for National Statistics shows that South of England has seen an increase in population, while other parts of the country have seen their populations increase at a much smaller pace or even decline. Population growth in the region was the fourth largest in England behind the East of England, London and the South West where population increased by over five percent between 1991 and 2001, while the populations of North East and North West decreased by -2.73% and -1.63% respectively.

The latest data shows that population in the region increased by over 370,000 or 4.95% (0.48% per annum) to just over 8 million between mid 1991 and mid 2001.[3] This was a much higher increase than in England as a whole which saw a population increase of 2.73% (or just 0.27% per annum) over the period.

Milton Keynes Unitary Authority (UA) and Slough UA had the highest increase in population in the region of 16.43% and 13.0% respectively, while Havant in Hampshire had the greatest decrease in population of –2.4%. Windsor and Maidenhead was the only UA/County to experience a decrease of population.

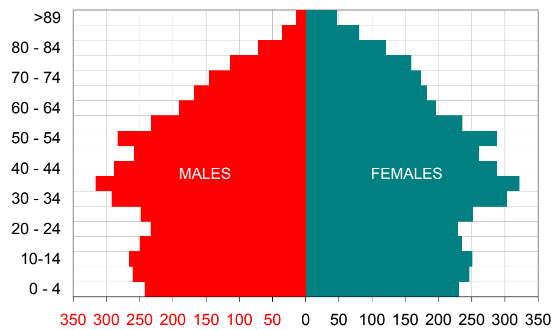
Figure 5: South East England: Population change 1991-2001



The total number of children (0-15 age group) in the region increased by 79,800 or 5.27% over the period. This is an encouraging sign considering that over the past two decades the general population has been getting older. At present, there are 95 males per 100 females in the region. The main factor behind this has been higher life expectancy for females than males and lower probability of females to migrate out of the region than males. However the latest data shows that for the children’s age group (0-15 age group) there are 106 males per 100 females. Furthermore there are more males in the 0-24 age group than females. As we move up on the population pyramid (Figure 6) the proportion of females rises. In fact there are more females in every age group over the age of 24 (except 40-44 group).

The working age population increased at a marginally higher pace (by 231.100 or 4.94%) than people over the working age (66.800 or 4.64%).[4]

Figure 6: South East England: Population distribution



Source: 2001 Census

The working age population in the region increased at a much smaller rate than the population in London, which is not surprising considering that London had a much larger influx of immigrants (largely young people of working age). However, unlike London which has seen a decrease of people over the working age by -7.39% this group increased in the region and is likely to increase at a much faster rate than in most other parts of the country.

[2] International Labour Office (ILO) unemployment

[3] Mid 1991 estimates are final revised estimates, while figures for mid 2001 relate to 30th June 2001.

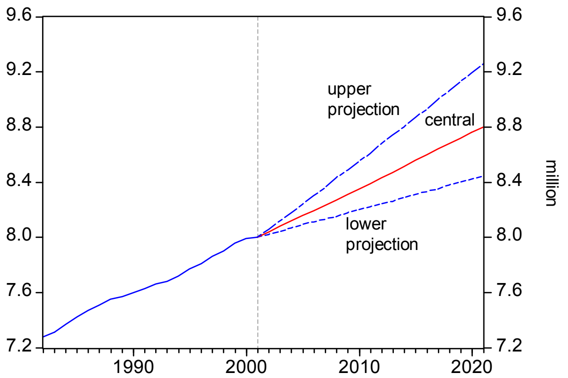
[4] Working age population reflects the age group 16-64 for males and 16 to 59 for females, while by people of not working age we mean males of 65 and over and females of 60 and over and children and young people (0-15 age group).

The prime reason behind this inflow of older people from other parts of the country and in particular London is better 'quality of life' in the South East than in most other English regions. In years to come, as more people get older they are increasingly likely to move from large urban centres such as London to other areas with the South East receiving a significant share.[5]

WE MAY NEED A GREATER INCREASE IN THE WORKING AGE POPULATION IF WE ARE TO SUSTAIN THE CURRENT STANDARD OF LIVING IN YEARS TO COME

The latest population statistic shows that the region has been growing at a much higher pace than England as a whole. Assuming that the current trend continues (holding all the other factors constant) by mid 2021 the population is projected to increase by 10.05%, with an extra 800,000 people in the region than in mid 2001.

Figure 7: South East England: Population projections



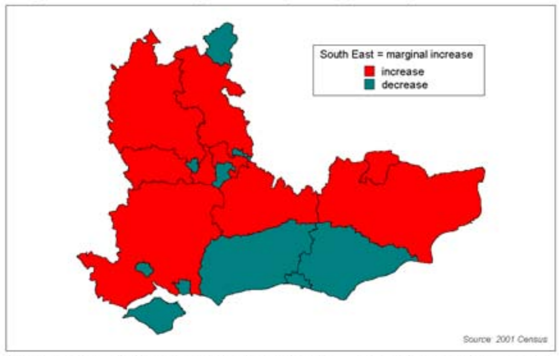
Source: ONS 2003 and SEEDA 2003

Although there are some encouraging signs which show that the children's age group (0-15) has been growing faster than the old age group (people over the retirement age), this may not be enough to offset the impact of the general population getting older in years to come.

The dependency ratio in the South East has marginally increased between 1991 and 2001.[6] The highest dependency ratio was in East Sussex (80 per 100 people of working age), while the lowest was in Reading UA (51 per 100 people of working age). The greatest increase in the ratio of 4.2 dependant per 100 people of working age was in Wokingham UA, while the greatest decrease of -9.9 was in Brighton and Hove UA.

The increase in dependency ratio may not be a bad thing (on the contrary) as long as it is driven by an increase in children and not by an increase in people of old age.

Figure 8: South East England: Change in dependency ratio 1991-2001



A closer examination of the data reveals that in percentage terms total number of children has risen marginally faster than 64+males/59+females age group. Dependency ratio is likely to increase in years to come largely due to ageing population and longer life expectancy.
Mean population age in the region in 2001 was 39 years and is likely to increase in years to come with almost one in four people of current working age retiring between now and 2016 [7].

Within the next 10-15 years the post war 'baby-boom' generation will retire, there will be more people of pensionable age than children. The consequence of this is that the working age population will decline in relation to people of pensionable age, while at the same time we are going to need greater resources to pay for vital services.

There are only a handful of ways we can sustain the current living standards in the presence of an ageing population. Significant increase in productivity is one of those, however, historically we have not been successful in increasing productivity in comparison to our major competitors. Another solution may be to increase the participation rate, by allowing people to work longer or by having larger population growth.

Given that the population in the region is getting older and the employment rate is at a record high, increase in population and higher participation rates in years to come are likely to be needed if we are to avoid lower rates of economic growth in the future.

[5] By 'quality of life' we mean large areas of natural beauty, provision of social services, availability of good hospitals, lower crime rates etc.

[6] Dependency ratio = ration of young people of non-working age (0-15 age group) and people above the working age (64M+/59+F) to working age population (16-64M/59F)

[7] Median age in the region in mid 2001 was 38 years.