Regional Economic Development
Business Intelligence Report: Spring 2015[1]

The Economy in Summary

In 2014, the UK economy grew 2.8%, inflation averaged 1.5% and unemployment moved back below 6% of the workforce. Above trend growth, low inflation and falling unemployment is all good news.

Structurally, however, the called-for economic rebalancing is not evident. Last year, the recovery was consumer driven, the external and public deficits were huge, and productivity was still barely growing. Manufacturing output has yet to regain pre-recession highs.

With interest rates low and stable, financial conditions remain 'unusual' whilst external factors are only adding to current uncertainty. Business investment is more subdued than would be necessary to sustain accelerating growth.

The consensus forecast is that the economy will maintain its recovery, but not accelerate, in 2015. The General Election is a near term uncertainty, as is the prospect of an EU exit referendum within the next two years. Meanwhile, many export markets are difficult and the six-year depression of household earnings is uncorrected.

Against this background, the local Dorset and neighbouring economies are in recovery mode but performance varies widely by firm and by sector, according to micro factors related to strategy, technology and market participation. Recent surveys suggest sales and investment expectations are reasonably good for the months ahead but 'wait and see' still seems to be the 'watchword' for many, major new business development projects.

Barring shocks, the recovery will persist though 2015. Yet, with little expectation of an aggregate productivity boost, with global market conditions fraught, with government austerity set to continue, and with living standards precarious, the economy may struggle to maintain momentum.

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[1] This is the first of what is to become a regular series of reports, supported by policy/data briefings that BU will produce for the business communities of Dorset and its hinterland.

The UK Macro Economy

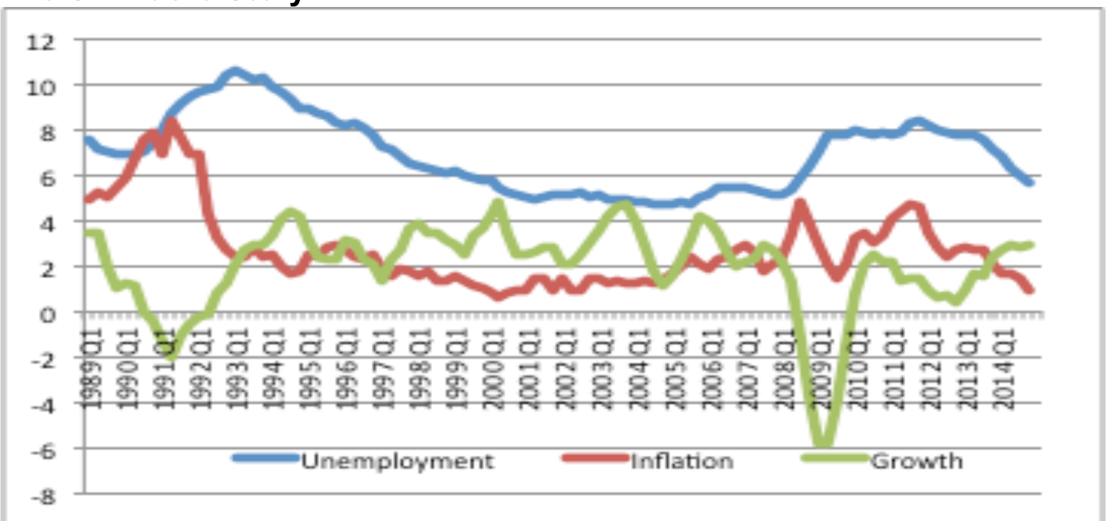
Latest evidence

	annual	quarterly	monthly
Real GDP (%ch)	+2.8 (2014)	+3.0 (Q4)	n.a.
CPI inflation (%ch)	+1.5 (2014)	+0.9 (Q4)	+0.3 (Jan)
LFS unemployment (%)	6.2 (2014)	5.7 (Q4)	5.7 (Oct-Dec)
Trade deficit (£bn)	-34.8 (2014)	-7.1 (Q4)	-2.9 (Dec)
Base rate (%)	0.5 (2014)	0.5 (Q4)	0.5 (Mch)

Source: ONS

The UK economy is recovering (see chart below). After the longest period of downturn since the 1930s, (almost six years), the eight-quarter recovery has finally pushed the growth rate above its trend potential. Productivity is contributing little to growth: most of which is coming from higher employment. Unlike most economic cycles in living memory, this one has been characterised by coincident rather than lagging labour markets, a persistence of output gaps and an unusual policy mix.

The UK Macro Story



Source: ONS: growth = Real GDP % change year-on-year, Inflation = CPI % ch yoy, Unemployment = LFS % rate

The economy is moving ahead despite a stressed global economy and non-stimulating stabilisation policies. It is growing despite weak household incomes and business investment. Apart from a replacement cycle and some activation of excess personal liquidity, the UK appears to be "running on empty" with the main drivers of the "growth chain" remaining fragile. Something has to improve in terms of demand and supply rebalancing, if the economy is to go from a hopeful recovery to a sustained, and sustainable, upturn.

The Dorset Micro Economy

Despite its own spatial and sector idiosyncrasies, Dorset's economy mirrors UK trends quite faithfully. There are relative response leads and lags, reflecting proximity to markets and other structural and network characteristics, but Dorset seldom deviates from overall trends for long.

In labour terms, Dorset enjoyed a fairly benign recession and downturn. Compared with some areas, it has been able to use its workforce without significant hidden unemployment or under-employment whilst maintaining flexible working. There are differences across the patch, with the official unemployment measures lower for Poole than Bournemouth for example. These represent differences of structural detail rather than cyclical trends.

At the end of 2014, for example, the claimant count rates in Bournemouth, Dorset County and Poole were 1.6%, 0.8% and 1.1% respectively. These compared with averages of 1.5% for both SW and SE England. The more useful LFS rates are not published as regularly as the claimant measure at this level of geography. But, for SW England as a whole (including Dorset), the LFS unemployment rate was 4.5% in the October-December period: amongst the lowest of all regions (UK average of 5.7%). Bournemouth's rate tends to be above whereas Poole and the rest of Dorset are usually below the SW average.

The Dorset economy is worth about £16 billion per annum in terms of gross value added (GVA) – the standard sub-national measure of total income or local output (latest available data for 2013). This figure represents about 13.5% of the SW economy: itself 7.5% of the total UK economy. Bournemouth and Poole contribute slightly more GVA than the rest of Dorset but, essentially, it is a 50:50 split between the two areas.

The interesting difference, however, is in terms of GVA per head where Bournemouth and Poole together produce £22,981 annually and the rest of Dorset averages £18,293 (2013 prices). These are 98% and 78% respectively of the UK national average. The difference within the county reflects structural economic and demographic factors, including sector/value locations, workforce/commuting patterns, and residential age distributions. In broad terms, the former is fairly good for an urban area outside London and the latter is reasonable for a more rural area. Most problems in the local economy are ones of success rather than failure.

There is no room for complacency, however. Competing places are not standing still and, whilst these things change slowly, there is a small tendency for the gap within Dorset (20 percentage points) to widen over time. Issues of low productivity and poor market engagement remain significant.

Meanwhile, recent business surveys paint a complicated picture about Dorset and its hinterland. Some indicate positive, albeit restrained, progress in recent months while some suggest activity remains volatile. Others indicate a gradual decline in the positive balances over the last four quarters. Companies are investing more, but cautiously. Divergence locally reflects sector and market variability and indicates the continuing patchiness of the recovery.

Nevertheless, businesses across Dorset are looking forward with some optimism for the middle of the current year. The issue is whether businesses can add to competitiveness, through innovation and investment, in a way that produces a sustained upturn by raising long term productivity. Sadly, official data will not answer this question for some time. Anecdotal evidence on local patterns of progress will remain vital for the months ahead.

What we do know is that productivity across southern England remains less than might be desired. In international terms, the UK's relative productive position, already low ranking over recent decades, has declined in recent years. Locally, the table below shows the latest data on productivity in Dorset and various nearby LEP (local enterprise partnership) areas in 2013.

Productivity – GVA per hour 2013 (smoothed UK = 100)

Dorset	92.7	Heart of South West	83.8
Solent	103.0	West of England	101.4
Enterprise M3	116.2	Gloucestershire	94.1
Swindon & Wiltshire	105.0	Cornwall & Isles of Scilly	72.0

Source: ONS

Dorset ranks sixth of these eight areas, with output per hour 7.3% below the national average, 10.3% below Solent but 8.9% above Devon and Somerset (HoSW). The good news is that this is the smallest productivity gap with the UK average since the recession started but the bad news is the progress is very modest (less than 1%). This is not too surprising: nowhere stands still and it takes a long time and a lot of entrepreneurial innovation and infrastructure investment to shift these relative scores.

In addition, Dorset's ranking reflects its underlying demographic and capital structure, especially its mix of rural and urban communities, its skills base, and its technological and sector specialisation – things that usually change slowly through time. Again, this reinforces the mixed view of Dorset's actual and potential performance: some good indicators and some bad ones.

The question for development policy and action, then, is whether to support those already doing well (gaining near term 'bang for buck'), those expected to grow well in the medium term (new activities with competitive potential), and/or those in need of a push to be more efficient and effective in the long run (failing to reach potential at present). This is always the dilemma of development intervention, at least those based on limited funding and industrial prioritisation.

The Economic Outlook

- In its forecast report published alongside the Chancellor's March 2015 Budget, the Office for Budget Responsibility (OBR) talked about growth in real GDP of 2.5% in 2015, a little slower than in 2014. It forecast inflation at 0.2% (much lower) and the LFS unemployment rate at 5.3% (also lower).
- In its latest inflation report (February 2015), the Bank of England postulated growth in a 2-3% range over the next couple of years, with inflation returning to target (2% per annum) by late 2016.
- The current consensus amongst the main UK private forecasters, as recorded by HM Treasury in March 2015, is for growth, inflation and unemployment of 2.7%, 0.8% and 5.3% respectively.
- Several business surveys suggest moderate-to-modest growth expectations in the months ahead.

In short, there is considerable agreement about the economic outlook for the current year, with growth about trend potential, inflation under target and unemployment making further gradual, downward progress.

Our perspective is that there are risks to the central view on both sides.

- The main positive risk is that, despite strong headwinds, micro expectations about earnings for business and households may underestimate consumer spending and investment.
- The main negative risks reflect the adverse external environment, further fiscal austerity and a continuing lack of real rebalancing, as well as political uncertainties
- Overall, at this point in time, the latter seem more cogent than the former. "Animal spirits" could turn upwards more than currently expected, but it might be more surprising if the economy accelerated than if it slowed through the rest of 2015.

For Dorset businesses, experience will vary by sector, with high value, market driven providers to other business more favoured than commodity, consumer orientated goods and services. For all, it is a case of being innovative and entrepreneurial, building skills, engaging with and in vibrant markets and investing sensibly in productive capacity and technology.

Nothing new there, then, one might say. The key is that, perhaps more than usual, business attention to the micro detail is more important than a focus on the macro climate in determining relative and absolute success or failure: short term returns and long term growth.