Regional Economic Development

Business Intelligence Report 18: Summer 2019[1]

Comment

I draw the curtain on my years as an applied regional economist this autumn. This will be the last BU Business Intelligence Report from this keyboard.

In my time as Professor of Regional Economic Development, I have had two main objectives:

1) working with business, public agencies and other partners to promote the Dorset economy and BU's role in it; and

2) providing BU's external contacts and internal colleagues with analysis of the current state of, and outlook for, the local economy.

This quarterly series of Business Intelligence Reports has been an important anchor for that evidence building, offering insight into the latest national and local trends and how they might affect future prospects and decision making.

Since the first BIR was published in early 2015, **Dorset's economy has been growing slowly, tending to lose momentum over time but achieving full employment**. It has faced an intensification of some of the structural problems of success – such as an ageing population, skills and housing shortages, and urban congestion. Also, it has displayed fundamental weaknesses in investment and innovation, causing flat productivity levels and weak, if any, productivity growth. Thereby, on average, Dorset ranks only modestly on competitiveness.

---

[1] This is 18th of a series of regular economic overviews that BU has produced since 2015 for the Dorset and neighbouring business community and its development partners.

Since 2016, the economy has faced an **uncertain national policy background.** It seems that global policy makers have forgotten that mutual trade and exchange based on strong productivity is the only sustainable source of wealth and well-being. The populist isolationism of 'Brexit and Trump' has, and will, damage current UK competitiveness. Whatever your view of the politics of these issues and how you believe they will turn out in the end, these factors have subdued, and will probably continue to subdue, real economic activity, (especially diverting and lowering investment and trade) from what it might otherwise have been. 'Brexump' has cast a shadow over near-term activity, flattening investment, lowering growth rates and stifling future development prospects.

The slow but steady loss of momentum experienced since the UK's 'leave' EU referendum and the start of the US-China 'trade wars' means the UK economy is on **the verge of recession**. Several signals (see next section) suggest it is near a point of negative inflexion, including output and demand data, business surveys and a number of major disinvestment and closure announcements.

Moreover, the authorities enter this period **without any strong countervailing policy levers**: the pound is already weak, money is already (too) loose and the room for 'safe' fiscal stimulus is moderate. Any negative 'shock' will meet modest policy resistance, especially as the UK is highly exposed by its large external deficits and debt. This is a precarious and daunting position for new Prime Minister Boris Johnson, new Chancellor of the Exchequer Sajid Javid and (soon) a new Bank of England Governor to address.

In the face of profound demographic, technological and climate change, an era of populist **'me first'** strategies and policies is exactly the opposite of what is needed. Leaders should be embarking on a concerted effort to "co-operate to compete" rather than more isolationism. International tensions are rife (the Koreas-USA-China-Hong Kong, Ukraine-Russia-Iran-Syria-Turkey, UK-Iran-Saudi Arabia-Yemen, Kashmir, DR Congo, Venezuela and EU-Italy). At home, fears for the Union are growing as local populism trumps (sic) overall wellbeing.

It is disappointing that my professional life winds down with many key 'actors' seemingly set on "doing things worse and doing worse things". Didn't we learn these lessons, painfully, in the 1970s? Once again, it seems, people will have to relearn, the hard way, the fundamental truths about the process and pursuit of sustained economic development.

There are **rays of hope** for the long run, however. For the late 2020s and beyond, a time likely to be dominated by dynamic and difficult technological, social and environmental change:

1) the young people coming through (BU, other institutions and other routes to employment) can become the progressive, political, business and entrepreneurial leaders that Dorset needs for a market-driven and regulatory-based, sustained and sustainable, future;

2) there are plenty of dynamic, innovative and resilient businesses in Dorset that can prosper even through difficult times and, hopefully, given a lessening of strategic uncertainty, can respond to future opportunities; and

3) there is still a chance that adversity breeds solution - my short-term fears are exaggerated, 'common sense' prevails, and open-minded self-interest re-asserts itself.

Local personal and **corporate GEMS** (growth engaged makers and servers) range across a number of industrial sectors. Indeed exciting 'clusters of clusters' are emerging in new technologies and markets (e.g. through health and defence/engineering technologies and services) that, with a fair political and policy wind, can:

a) generate sustainable economic development,
b) promote social and economic wellbeing, and
c) improve environmental capital and amenity.

To this end, for the Dorset LEP and its partners, I have prepared an evidence-based narrative as part of the varied input to the forthcoming **Dorset Local Industrial Strategy** (LIS).

The investment priorities derived from my analysis of the evidence, strengths and opportunities, together with local ambition and expertise, are clear. Dorset needs to raise the productivity incentives and achievement of its **coastal city-region** and its hinterland, by raising the average and aggregate performance of local firms - encouraging competitive entrepreneurship, business innovation and skills renewal - and by investing in enabling structures and systems to improve **bespoke connectivity** and **environmental-economic fusion**.

The Dorset LEP's 'deep dive' analysis of precisely where future investment should be focussed, within these broad priorities, is now underway. Before the year's end, a robust, inventive, realistic yet challenging LIS framework for

Dorset's future should emerge. Hopefully, this will receive local and national endorsement, acceptance and funding in 2020.

As Dorset drives for a **distinct, more productive and competitive future**, its LIS and local firms have to offer a 'net gain' in social and environmental capital and amenity as well as a dynamic, high earning/high employment economy founded on 'new' technologies, sectors and markets.

Having lived through and studied half-a-dozen downturns and recessions since the early 1970s and having lived in and analysed Dorset for most of that time, I can only wish the best for locals, incomers and grockles alike. Local businesses face another era of disruptive development but let's hope any imminent cyclical crisis is short and shallow.

Thank you for reading and listening … and may the eventual recovery yield a sustained upturn, bringing renewed happiness and good fortune to you all!

Evidence & Outlook

UK	Annual (2018)	Quarterly (Q2 2019)	Monthly
Real GDP (%ch, yoy)	+1.4	-0.2	+0.0 (Jun)
CPI inflation (%ch, yoy)	+2.5	+2.0	+2.1 (Jul)
LFS unemployment (%)	4.1	3.9	3.9 (Jun)
Trade Balance (G&S, £bn)	-30.9	-4.3	n.a.
Base rate (%)	0.60	0.75	0.75 (Aug)

Source: ONS

Through 2019, the UK economy (see table above and chart below) has been slowing down. Indeed, it has been losing momentum for some time and may now be moving from a slowdown into a downturn. (Annoyingly, confirmation of this must await ONS data to be released shortly after the Halloween Brexit.)

In the first quarter, **real GDP** increased 0.5%, up 1.8% year-on-year. This performance saw services, construction and manufacturing all boosted by intense stock building ahead of the first Brexit deadline (29/3/19) and fears of border delays. Performance was weakened by slowing housing and nervous financial markets. Driven partly by these inventory trends, the drag from net trade worsened (deficit = 3.7% of GDP).

Importantly, around the globe, other economies were also slowing down and, in the second quarter, the **growth rate** dropped by 0.2% (down to +1.2% year-on-year) under the weight of:

1) an end to emergency inventory building,
2) a global slowdown and financial nervousness, and
3) delays in commercial investment in all its forms (new buildings, equipment and staffing).

The **production sectors**, especially manufacturing (-2.3%) and construction (-1.3%) declined whilst the services were barely positive (+0.1%). Chemicals (-6.2%) and transport equipment (-5.2%, led by cars) were particularly weak. Having been in a negative run for a year or more, motors output was decreased further by temporary plant closures and threats to future model lines. Industrial investment intentions have dropped sharply. Manufacturing returns/profit ratios (Q1 average only 12.2%) are under pressure.

Services continue to plod forwards (+0.1% April-June on January-March) but the aggregate figure hides some volatility, (from info and comms +0.14% to -0.04% in leisure) again driven mostly by Brexit uncertainty. Service profitability (+19% Q1) is still buoyant.

Consumer spending has been hurt by fewer foreign visitors and the wider political uncertainty. **Retail sales volumes** have been positive but volatile (weak June and stronger July) significantly influenced by promotions and discounting. The switch from high street to on-line remains the main retail story. Department stores and household goods stores are in relative decline whereas non-store and some specialists are performing well.

Because the UK economy is softening, recorded **inflation pressures** are fairly modest but remain vulnerable to a number of external shocks:

In July, **input prices** (IPI) increased by 1.3% whilst **producer prices** (PPI) rose 1.8%. Both have slowed sharply over the last twelve months. Currency affected crude oil prices explain much of the input volatility.

Consumer prices (CPI) increased 2.1% in the year to July: an inflation rate close to the national target. Non-discretionary items (e.g. housing and household services) seem to be holding inflation up whilst discretionary items (e.g. clothing and footwear) still face highly competitive pressures.

Being close to target is a fortunate accident rather than a clear policy result. The repeated weakening of sterling suggests an inflation uptick to imported products and raw materials is imminent and this will feed through to final prices this winter and into 2020.

At the end of July, the effective sterling **exchange rate** index was 76.1 down from 79.9 in January and compared with a recent peak of 93.5 in mid 2015. It has slumped further in the summer on growing fears of a 'no deal' Brexit. The pound is particularly weak against the US dollar – setting cyclical lows through July and August. In response, the cost of living is set to rise this winter at a time of weakening activity growth. Inflation faster than growth is often a signal of negative economic times (see chart below).

The UK economy displays **fundamental weaknesses**, adding up to absolute and relative deficiencies in productivity:

- Investment and innovation has been weaker here (UK) than elsewhere for a decade. Soft absolute levels mesh with unfavourable relative performance and trends. (UK output per hour was still falling through the first half of 2019.)

Despite some strong research leadership in key technologies, overall and average UK innovation rates have always been lower than for many of our competitors. Narrowing trade relationships will make this worse.

To **raise productivity, and thereby economic performance, we need sustained, higher investment in ideas:**
from basic research and invention,
through product and market change,
to behavioural and process reform,
promoting positive economic-environmental fusion.

- Many local corporates complain about skills mismatches and some lack of aspiration amongst entrepreneurs, as populist uncertainty gathers influence. Forecasting demand for future skills is notoriously difficult. What can be said is that a significant part of the experienced workforce will reach retirement age over the next decade, especially in Dorset.

  Replacing existing skills needs will be important as well as satisfying the demand for new ones. **We cannot raise productivity, and thereby economic performance, without higher and sustained investment in people:** from spreading basic STEM and other skills, through replacement, renewal and reinvention of new high-tech and living skills, to the attraction and retention of advanced and dynamic workers in new areas, including economic-environmental fusion of investment and outcomes.

The UK economy just is **not competitive enough**. It has neither the capacity nor the drive to rapidly expand its share of world trade. Of course, the 'Brexiteers' suggest this will come after leaving the EU in response to new market opportunities and trade diversion to home producers. But, in a world in which trade negotiations take years, it is hard to see how such a shift in ambition and risk taking will come quickly, especially in the face of more isolation from other important trade blocs and agreed standards, and the likely imposition of adverse WTO tariffs.

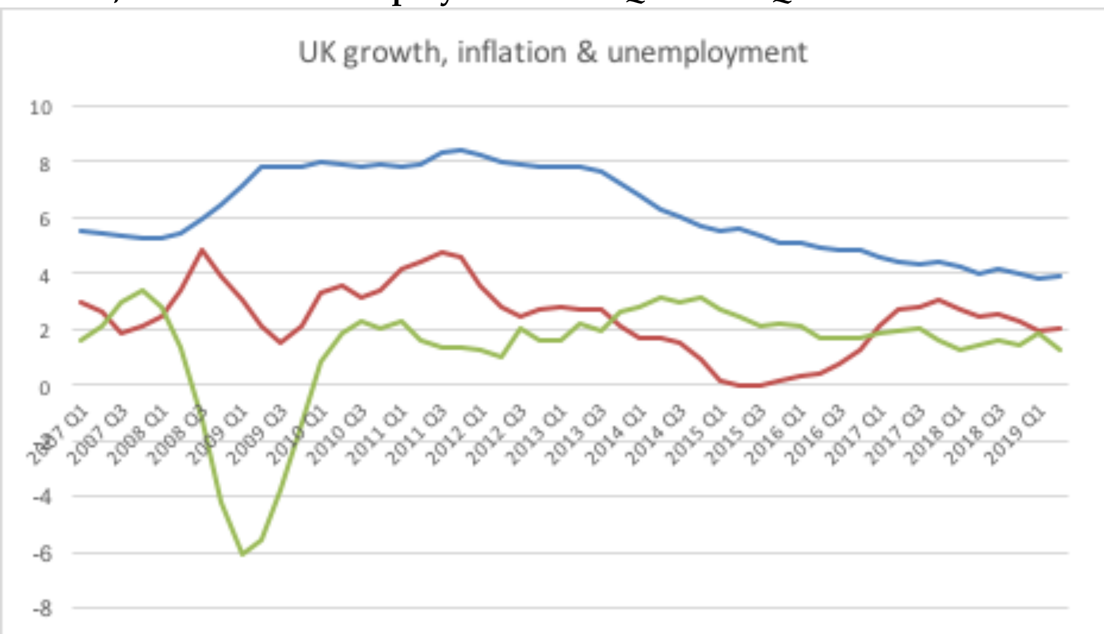
Meanwhile, the country has to finance huge national deficits by borrowing (from the future). In the first quarter of 2019, the current account deficit hit £30bn, or 5.6% of GDP. The trade deficit hit a record £20bn. This is unsustainable in the long run – double or more above an 'acceptable' ratio. The business stocks story may mean some of this was a temporary hike (the second quarter suggests so) but it only worsens an already adverse underlying picture.

The UK economy is further hamstrung by **political and policy uncertainty**:

- BREXIT means a lonelier and more difficult world for UK traders.
- The Union is threatened by splits of ambition in UK society.
- Extremes of austere fiscal policy may be over but the coffers are still fairly bare, without higher taxes or borrowing.
- Monetary policy is already too loose with little room to help an economy in distress.
- Trade policy is a mess and weakened by a fundamental lack of industrial capacity – what are we selling to whom, when and how?
- Global trends and dynamics are slowing and deteriorating under "me first" approaches by several key regimes and an adverse yield curve.

It would be nice to say there are countervailing positives but it is hard to see them. Asserting it will 'be all right in the end' is no substitute for strategic thinking, practical application and real investment. I will cheer if I'm wrong, but the UK economy faces a difficult outlook through the winter of 2019/20 and hard choices beyond. Even if we had a world of greater harmony with falling trade barriers, there are important threats to overcome: – demographic and climate change and technological, markets and skills transformation. **An era of trade wars, investment strikes, and sub-optimal shifts in relationships will only make these profound long-term adjustments worse**.

Growth, Inflation & Unemployment: 1989 Q1 – 2019 Q2



Source: ONS: Growth (green) = real GDP % change year-on-year (yoy).
Inflation (red) = CPI % ch yoy. Unemployment (blue) = LFS % rate.

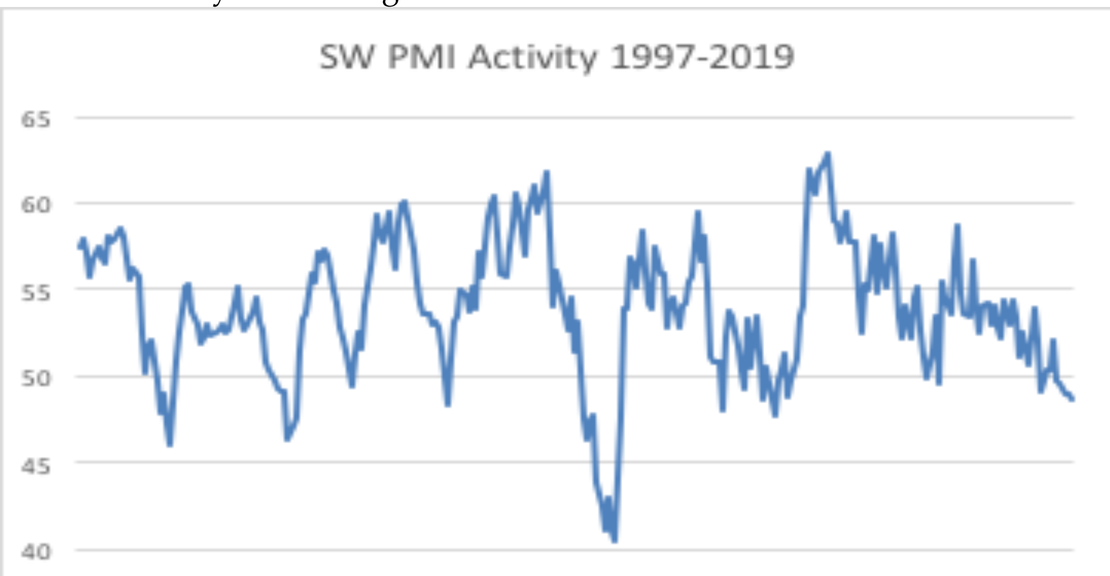
Local Conditions

Current local conditions largely reflect the national malaise:

It is ironic that, for the first time, the ONS is to publish regional GDP figures quarterly from September 2019 – just too late for me. Regional economists have been lobbying for these for at least two decades.

So, once again, this report focusses on recent survey evidence. The regional PMI[2] series remains the best, most up-to-date measure of **current performance and sentiment** (see chart below). It shows, (apart from the post referendum shock in 2016), a steady loss of momentum since 2013. Moreover, the SW activity index (including Dorset) has been negative (i.e. below 50) for 5 months (March to July) whilst the SE index (not shown) turned negative in June. If August continues this trend, SW England will have had two-quarters of regional decline = recession.

The PMI Survey for SW England 1997-2019



Source: Markit

In more detail, the latest PMI release showed the following: new SW business order books negative since May and outstanding business negative since last November. Employment turned negative in July. Despite this, the future

[2] Nat West sponsored IHS Markit UK regional purchasing managers' indices

outlook expressed by respondents remains positive. Once again, SW firms remain optimistic about their own prospects whilst displaying some disquiet about 'others'. It is unclear whether this is wishful thinking or foresight. This imbalance should resolve itself, one way or the other, in due course.

Other **surveys & anecdotes** show a similar picture of slowdown, as businesses hold back expenditure for fear of political uncertainty and trading risks. At recent business events in the local area, I have heard a range of views:

> from "everyone's sitting on their hands – only unpostponable investment is being undertaken"
> to "we're working flat out now - but I'm not sure it will last".

Many professional advisers, (accountants, bankers, lawyers and consultants) talk of customer/client nervousness and a lack of future decision making amidst a hopeful ethos of "carrying on". The local mood is vulnerable to an adverse outcome on Brexit.

Furthermore, local opinion accords with national and regional views as expressed by such as recent BCC (Chamber of Commerce), ICAEW (Chartered Accountants), and other surveys and by negative announcements from a range of primes in, amongst others, steel, shipbuilding, aerospace, motors, agriculture and the high street. There are also reports of some UK firms already being 'shut out' of EU supply chains and research initiatives.

- The **BCC survey** of over 6,800 businesses talked of growth stalling in Q2, with manufacturing orders (domestic and export) suffering lows. Services were better than Q1 but not sufficient to recover 2018 levels. The survey said, "relentless Brexit uncertainty, rising business costs and tougher global trading conditions" are impacting the UK economy.

- The **ICAEW survey** recorded that confidence is on a firmly downward trend driven partly by a global slowdown for exporters. Profits are under pressure from late payments and spare capacity. Costs are increasing more than prices. Capital spending is growing more slowly.

The pessimistic mood is reflected by many UK **forecasters**. Officially, in July, the **Office of Budget Responsibility's** relatively benign forecast was for a 2% real GDP loss in 2020 after a 'no deal' Brexit, potentially doubling UK borrowing. In 2024, without a deal, the economy is set to be 1.6% below what would otherwise have been the case, with a deal. The "pre-Boris" Treasury and the Bank of England were/have been even more negative than this.

Also in July, the **National Institute (NIESR**), one of the longest established independent UK model-based forecasting bodies, said the UK economy had already stalled and may be in a technical recession (two quarters of negative growth). It forecasts a severe downturn from a 'disorderly Brexit' and no more than 1% growth in 2020 and 2021 if a 'good deal' is done. Its current 'best guess' is for no growth in 2020 and inflation surging to 4%, perhaps requiring sharp interest rate hikes.

Number forecasts are often wrong but the current tenor is worrying and under-exposed by so-called neutral media.

Meanwhile, most local areas still exhibit high (full) **employment** and low unemployment rates. For example, as shown by the table below, Dorset County (DC), in aggregate, has almost no spare labour capacity and Bournemouth, Christchurch and Poole (BCP) very little. Both of these new unitary areas have inactivity rates under 20%. Once again, it is job/skills quality that is the issue rather than quantity. Under and hidden unemployment are the labour story for policy makers and local businesses. Moreover, long-term strategies to replace an experienced retiring workforce are going to be crucial.

April 2018-March 2019	Employment (%)	Unemployment (%)
UK	75.2	4.1
SW England	78.9	3.0
BCP	77.6	4.2
DC	78.8	2.5

Source: ONS July 2019

Conclusion

Dorset has some very dynamic businesses in key production industries and services.

- It has a record of high net business creation and resilience.
- It has few main 'primes' but a range of 'gems', including clusters of firms in advanced engineering, consumer products and creative and other tech-based activities.
- Its problems are largely those of success, including ageing congestion and skills gaps.

Against this background, if the deteriorating macro environment can start to be reversed, it is possible to paint a more positive and dynamic future for Dorset's micro economy. We are still clever and entrepreneurial. Adversities can yield opportunities. Let's hope the relationship is universally positive rather than exploitative.

The main bugbear is the high degree of political and policy uncertainty that faces local firms and workers in the near and mid-term future. It could be a rough Winter ahead and take several years to resolve current barriers to growth and prosperity. I hope the balance of this final analysis is too pessimistic, … but be prepared.

Bournemouth University

Nigel F Jump, Professor in Regional Economic Development