

**ECONOMIC and
BUSINESS BULLETIN**

Winter 2004 / Spring 2005

Winter 2004/Spring 2005

Economic and Business Bulletin

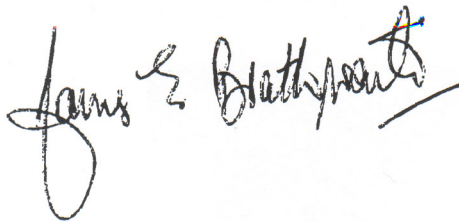
I am pleased to present the winter 2004/spring 2005 issue of SEEDA's six-monthly Economic and Business Bulletin.

This Bulletin aims to contribute to the development of business strategies in the private, public and voluntary sectors. It brings together key economic and business intelligence at regional level and puts the short-term outlook of the South East economy into a wider national context.

The next issue of the Economic and Business Bulletin will look more closely at sub-regional economic performance and its likely development in the short, medium and long-term.

If you have any queries regarding this Bulletin or its contents, please contact Ivan Perkovic (01483 470 162), email: ivanperkovic@seeda.co.uk

Yours,

A handwritten signature in black ink, reading "James E. Brathwaite". The signature is written in a cursive style with a large initial 'J' and a prominent 'E'. There is a small red mark above the 't' in "Brathwaite".

James E. Brathwaite, CBE
Chairman

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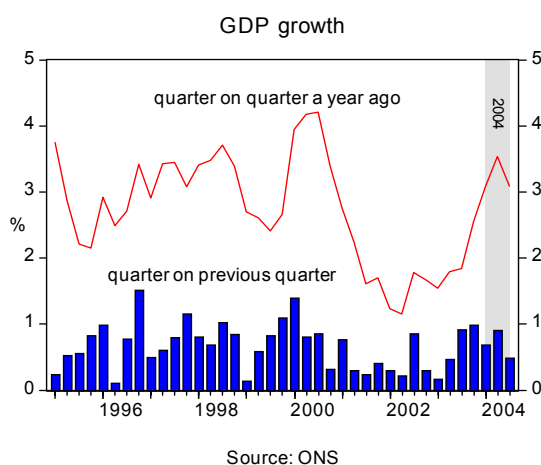
Executive Summary

- The UK and the South East economies expanded strongly in the first half of the year with strong growth in output, productivity and business investment.
- Service led activities and in particular financial & business services continues to underpin growth in real output in the South East and the UK.
- The manufacturing sector has emerged out of recession, but the recent appreciation of the pound combined with a weak demand from major eurozone economies threatens further revival next year.
- The latest survey evidence points towards slower growth in the third quarter of the year. Slower growth in industrial output with some slowdown in service sector activities appears to be the main factor behind the recent slowdown.
- Consumer spending has shown some signs of weakness over the past couple of months as several increases in interest rates over the past couple of months start to have an impact on output growth. Slower growth in consumer spending combined with less favourable outlook for house prices is likely to lead to slower growth in output the next year.
- In spite of a small increase in inflation this year, inflation rate is expected to remain well below the Bank of England's target the next year.
- In 2003 and 2004 GVA and employment growth were stronger in the northern regions. The South East economy is ranked second best performing region in terms of growth of real GVA in the country.
- In 2005 growth is likely to shift in favour of southern regions with the South East expected to outperform every other region in the UK.
- The growth in the region is likely to be underpinned by the strong performance of financial & business services supported by stronger expansion in transport & communications, manufacturing and public sector related activities.
- The labour market in the region appears to be relatively subdued (marginal increase in employment in 2004) this year, while strong growth in employment and further decline in unemployment is forecast for the next year.
- After a mild decline in employment this year, the financial & business services sector is expected to underpin the strong growth in employment in 2005. The trend of declining employment in manufacturing sector is expected to continue although at a slower pace than seen over the past decade.
- Economic inactivity among people of working age has risen over the past four years. There are now more economically inactive people of working age who want a job and are available to start work in the South East than there are people claiming Job Seekers Allowance.
- Inter-regional disparities in growth rates of real output appear to be narrowing over the past couple of years, while stronger evidence points towards narrowing of disparities in unemployment rates amongst English regions.
- Disparities in growth rates of real output between the South East counties reveal a rather different picture. In the 1990s intra-regional disparities rose much faster than inter-regional disparities.
- Rising disparities between the South East counties imply the emergence of a two-speed economy, and place a question mark over overall performance of the South East economy.

The UK Overview and Outlook

The latest revisions to UK Gross Domestic Product (GDP) growth rate show that in 2003 the UK economy expanded by 2.2% faster than initially estimated.¹

Continuation of the recovery in world demand alongside strong domestic demand have led to strong growth in UK output in the first half of 2004. UK GDP expanded by 0.7% (over the quarter) in the first quarter of the year. The growth in the second quarter was even stronger with total GDP expanding by 0.9% over the previous quarter.



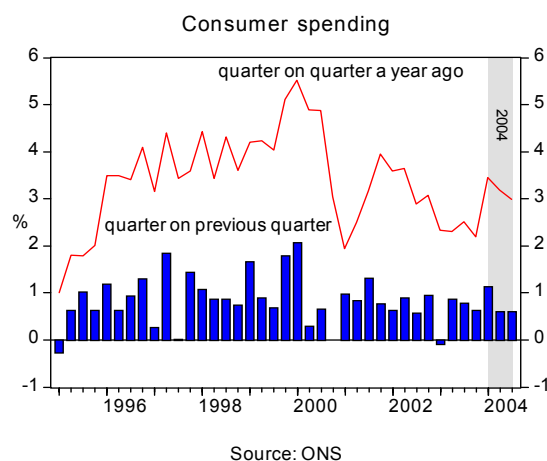
The latest estimates for the third quarter of the year show slower growth in GDP. GDP is estimated to have grown by 0.4%.² Slower growth in the third quarter largely reflects a decline of output in oil and gas extraction and 1% falls in the manufacturing output (largely in paper, printing & publishing, food drink and tobacco and chemicals and man-made fibres industries). The growth was underpinned by strong expansion across service sector. Financial and business services expanded by 0.9% while construction, transport & communications, distribution, hotels & catering and public services expanded by 0.8% respectively.

Retail sales growth has slowed down in the second half of the year with the volume of retail sales in the three months to October 1.2% higher than in the previous three months. During the first six months of the year, the equivalent three-monthly growth rates averaged 1.8%. Overall, household expenditure increased by 0.5% on previous quarter.

¹ Growth rates reported in this document refer to real growth rates (adjusted for inflation) unless otherwise stated.

² These are preliminary estimates partially based on survey data and are likely to be revised in the fourth quarter (the recent trend by the Office for National Statistics (ONS) has been to revise those rates upwards).

There was a strong growth in government expenditure, which rose by 1.4% over the previous quarter (4.7% on the same quarter a year ago).



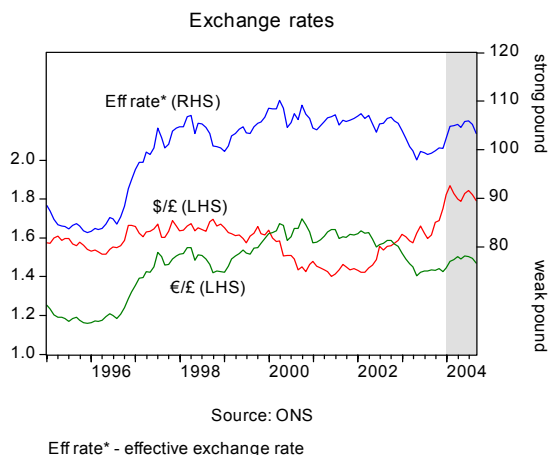
The latest survey evidence points towards stronger growth in output in the last quarter of the year. The output is likely to expand by around 0.7% in the last quarter of the year which implies that the economy will achieve the longest uninterrupted growth in output in modern times (50 successive quarters of continuous growth). The latest estimates from Experian Business Strategies (EBS) show the UK GDP expanding by 3.2 this year (the consensus of independent forecasters is for growth rates above 3% this year). The implication of this is that the Chancellor of the Exchequer will have proved his sceptics wrong once again with his forecasts of 3-3.5% for this year made in the April's budget.

The latest forecasts for the next year by Experian show UK GDP expanding by 2.8%. The consensus of independent forecasters shows average growth rate of 2.6%, considerably lower than the Chancellor's pre-budget forecasts of 3-3.5%. The main factors behind slower growth in output next year are likely to be slower growth in external demand and slower growth in consumer spending). The full impact of several increases in interest rates are likely to be felt next year since it takes 12-18 months for the rise in interest rates to fully feed into the economy. Consumer confidence is also likely to be affected by the expected slowdown (or decline according to some analysts) in house prices.

On the other hand, exports could get affected not just by slower world demand but also by the recent appreciation of the pound. In early December, pound has reached record levels towards US dollar over the past twelve years (\$/£ of 1.93). With rising 'twin deficits', US Federal Reserve will be unlikely to intervene to try to stop the slide of the dollar over the coming months. The implication of this is likely further appreciation of the pound.

The pound is likely to appreciate even further, possibly reaching \$/£ 2 in early 2005.³

A stronger pound implies that UK producers are becoming increasingly less competitive since the UK goods and services exported to US market become more expensive. A stronger pound will also have adverse impact on our competitiveness in Asian markets, since major economies in the Far East (such as China) have effectively pegged their currencies to US dollar, which implies that their producers are increasingly becoming more competitive at the expense of UK exporters.

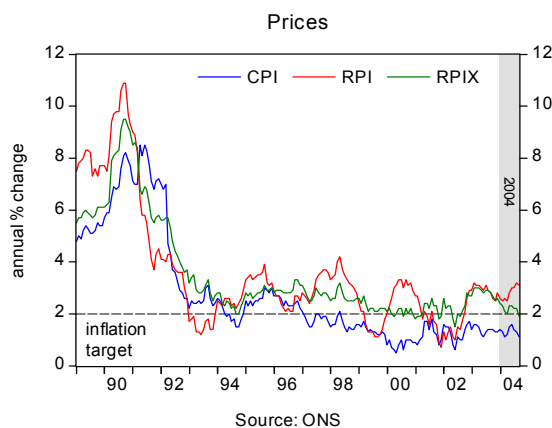


On the other hand, the pound has marginally depreciated towards the euro. In June 2001 one euro was trading at 1.64 toward the GB pound, in June 2004 the market rate was 1.50 and in early December 1.43 pounds. This trend is expected to continue in coming years. This should make our exports to the EU markets more competitive, however the overall impact of improvement in competitiveness is likely to be relatively small in 2005 due to projected sluggish demand within the major eurozone economies. A falling dollar will also help contain inflationary pressures arising from higher energy and commodity prices since most of energy and commodity prices are traded in US dollars.

The Government's target measure of inflation – the Consumer Price Index (CPI), increased from 1.1% in September to 1.2% in October. Rising energy costs (gas, electricity and petrol) were the main factor behind the increase in inflation. Similar factors have led to an increase in the Retail Price Index (RPI) inflation rate. RPI inflation increased from 3.1% in September to 3.3% in October. Over the past several years the UK inflation has remained remarkably stable in spite of significant increases in energy and commodity prices (oil and gas have reached record levels while commodity prices have

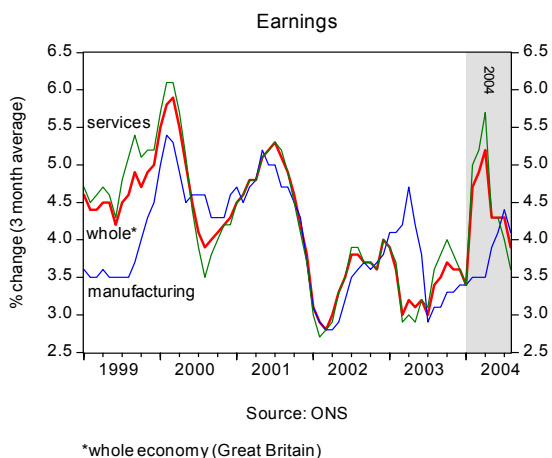
³ This could happen even sooner should the Bank of England raise interest rates in early December.

also soared, driven by strong demand from developing countries such as China and India).



One of the reasons why inflation has not risen sharply is due to the changing composition of the UK economy over the last three decades. The UK economy today is much more service orientated than in the 1970s hence the impact of rising energy prices on inflation is smaller than during the 1970s/early 1980s. Another factor that contributed to lower inflation over the past decade was fierce competition. Whereas in 1970s an increase in prices of inputs was often passed on the consumer, over the past decade it is the producers who often had to carry the brunt of rising costs (through a squeeze on their profit margins).

Throughout this period a rather modest growth in average earnings was another factor that contributed to easing of inflationary pressure. Average earnings showed stronger growth in early 2004 than in 2003, however since then we have seen a steady growth in average earnings. Average earnings excluding bonuses rose by 4.3% in the year to September (unchanged from August), while average earnings including bonuses was 3.7% (down from 3.8% in August).



Whereas in the 1970s inflation was driven not just by rising prices of inputs but also by spiralling wage inflation, the latest hike in energy and commodity

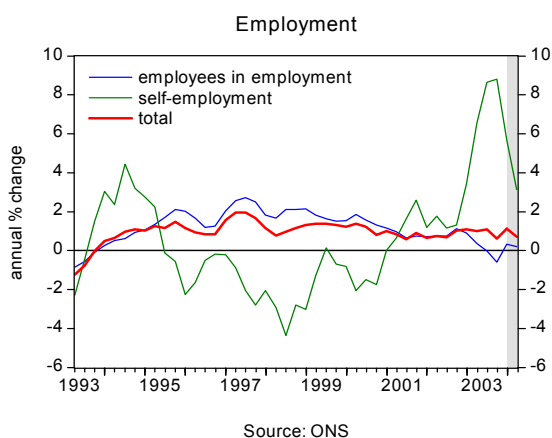
prices was not accompanied by any significant increase in earnings.

A comparison of internationally comparable measure of inflation, the CPI shows that since the start of 2000, UK inflation has been amongst the lowest in the EU (in September 2004 average inflation rate for the EU 25 was 2.0% compared with 1.1% in the UK). Over the next year CPI inflation is forecast to marginally increase on this year, however it will stay below the Bank of England inflation target of 2.0%.

Business investment in the third quarter of 2004 has reached record levels after rising by 0.1% on the second quarter and 5.7% on a year ago. Total manufacturing investment rose by over 9% and in services by over 7% on a year ago, while there was a decrease in investment in construction and non-manufacturing production.

Annual productivity growth for the whole economy in the second quarter of the year was 2.9%, up from the first quarter of the year, while annual manufacturing productivity growth was 5.4% (unchanged from the previous quarter).⁴ Acceleration of output growth and slower growth in employment were the main factors behind the strong growth in productivity.

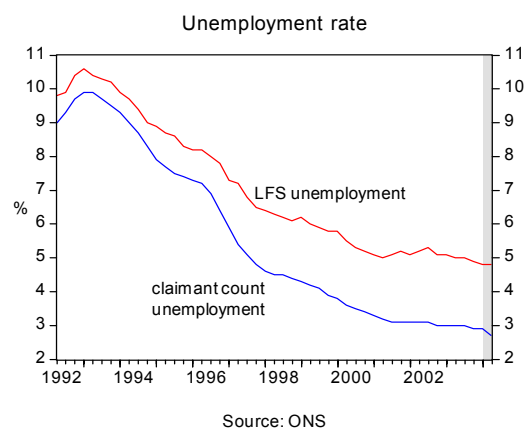
The UK labour market has remained remarkably stable over the first nine months of the year. Following an increase in employment of 55,000 over the second quarter and by over 230,000 over the year, total employment has reached record levels of 28.4 million. The employment rate in the third quarter was 74.7% up from 74.6% from the previous quarter. Furthermore there is some evidence in support of stronger growth in employee jobs over the past year.



⁴ Productivity growth measured as % change in the growth of output per hour worked.

This is an encouraging sign since a worrying trend has emerged in the past whereas most jobs were coming from increases in part-time workers and self-employment.

The unemployment rate (based on Labour Force Survey (LFS)) fell to 4.6% from 4.8% in the second quarter of 2004, the lowest level since the comparable records began.⁵ At the end of the quarter there were less than 1.4 million unemployed people in the UK. Alternative measure of unemployment – the claimant count marginally increased over the past two months following consecutive falls for over a year. At the end of October there were 836,000 unemployed people in the UK claiming Job Seekers Allowance (JSA).



Both the LFS and claimant count unemployment are forecast to marginally decrease next year.

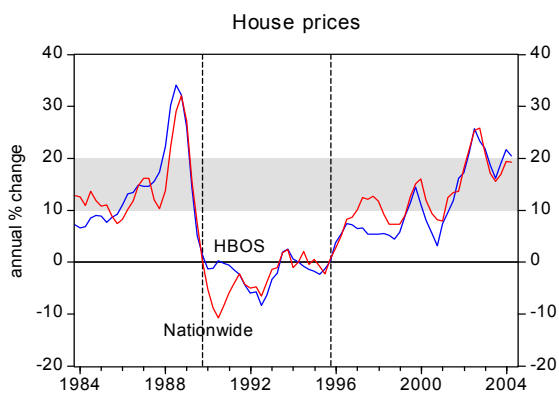
Although by international standards UK unemployment is one of the lowest in developed countries the UK labour market may not be as 'tight' as it may appear by simply looking at the latest unemployment statistics. There are still almost eight million people of working age in the UK classified as economically inactive and therefore excluded from the labour market.⁶ The total number of economically inactive people has risen by almost 400,000 over the past five years with students accounting for the largest share of the increase.

House price inflation has continued to significantly outpace the growth in average earnings in the first

⁵ The LFS or ILO (International Labour Organisation) measure of unemployment includes people without paid work who have sought work within the previous four weeks and are able to start work within two weeks. The claimant count measure includes only those people in receipt of job seekers allowance.

⁶ The economically inactive population includes those people who are not actively seeking work, those who are not available for work and those who are long-term sick or disabled (largely include those looking after the family and home, students and those who are sick or disabled).

half of 2004. Although, over the past couple of months we have seen some falls in house prices (largely contained to the southern parts of the country), house price inflation is still likely to end the year in double digits (between 10 and 15%).



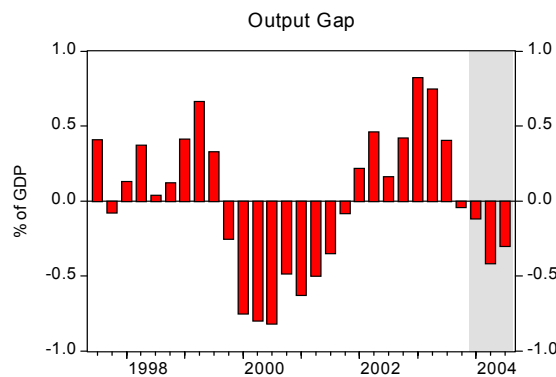
Source: Nationwide, HBOS

It appears as if several increases in interest rates over the past year are finally helping to cool the market. The issue here is whether we are going to see a slower growth in house prices or the 1990s style collapse of the market which contributed to the last recession and which could still push the UK economy over the edge. House prices are clearly overvalued, on some estimates as much as 30-40% compared with their long trend average in relation to earnings (house price-earnings ratio currently stands at around 5.5). Unsustainable house prices and rising interest rates over the past year point towards much slower growth next year (or according to some analysts even crash of the market over the next 2-3 years). However, interest rates are close to their historically lowest level, while the labour market remains stable (two factors which have contributed to the early 1990's crash), both of which point toward a more gradual slowdown (with some drop in the prices in some areas) than the outright crash of the market. In the end, the psychological factor is likely to play the crucial role in determining whether we see a gradual slowdown or a larger drop in house prices over the next 12-24 months.

Barclays and Halifax alongside a number of economic consultancies such as Experian Business Strategies have put their weight behind a drop in house prices over the next two years, while Nationwide expects the house price inflation to marginally increase over the course of next year. Regardless of whether we see a gradual slowdown in house price inflation or a larger drop in house prices it is unlikely that the UK economy will find itself in recession over the next year.

Slower growth in output, low inflation, and receding house prices all tend to point towards lower interest

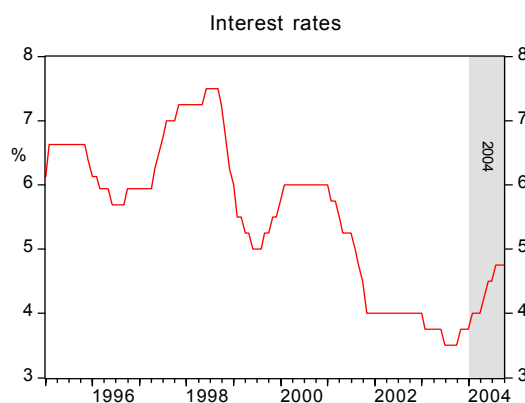
rates in 2005. However the answer to this is not quite straightforward as it first appears. It is true that economic growth has slowed down in the last quarter of 2004.



Source: SEEDA estimates derived from ONS data

However, our latest estimates show that the output gap in the third quarter was just 0.3% below its long-trend output.⁷ Thus there appears to be little scope for faster than trend GDP growth without creating inflationary pressures, which could lead to an increase in interest rates.

Furthermore, most analysts would agree that interest rates are still below their neutral level and that they would need to rise by a ¼ to ½ percentage points to reach their neutral level. It has taken several increases in interest rates over the past twelve months for the Bank of England to reach the current levels and the Bank is unlikely to rush with a cut in the rates. Thus, although the economy has slowed down over the past three months and the house price inflation is receding, interest rates are likely to stay where they are during early 2005.



Source: Bank of England

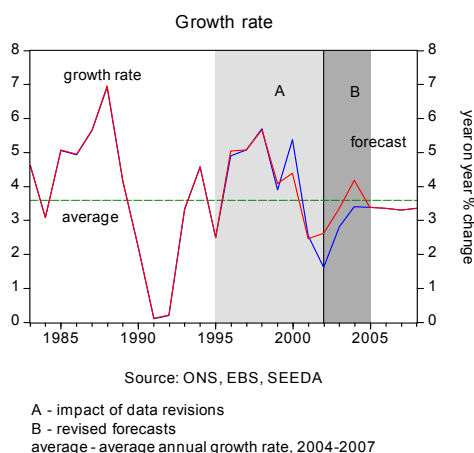
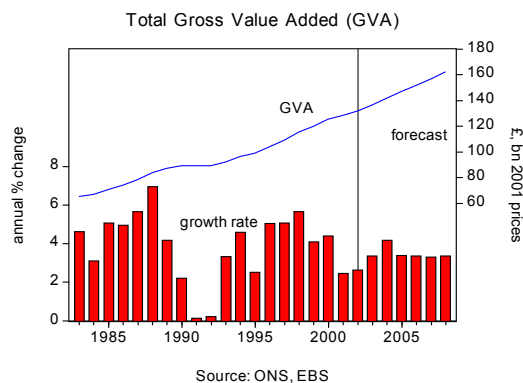
However, should the survey evidence point towards a slowdown in economic activity early next year and should the pound continue to appreciate against the US dollar (providing that house price inflation

⁷ The Hodrick-Prescott filter (Hodrick, R. J. and E. C. Prescott, 1997) has been used to estimate quarterly trend growth of output used to calculate the output gap.

continues to recede), the Bank of England may be inclined to lower the rates from their current level during 2005.

The South East Overview and Outlook

The latest (revised) estimates of regional Gross Value Added (GVA) show that in 2003 total output in the region expanded by 3.3% on previous year (as opposed to the growth rate of 2.8% reported in the summer of 2004).⁸

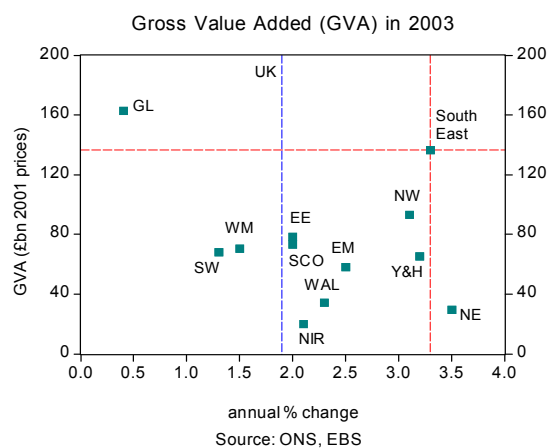


Some revisions to historical regional GVA have also occurred. These were largely due to changes in some components of Regional Accounts, National Accounts or some revisions to employment data.⁹ The revisions to the South East GVA are relatively small except for the period of the late 1990s when the growth was over-estimated and over the past two years when the growth was under-estimated.

⁸ In line with European Standards (European Systems of Accounts, ESA95), regional output is expressed as Gross Value Added (GVA) and not Gross Domestic Product (GDP), which is used to record output at national level. GVA is the net product measured at market prices, less taxes on output (levied at the point of production) plus subsidies (levied at the point of production).

⁹ For the methodological approach behind the construction of regional accounts see Lacey, D. (2000).

When compared to the other UK regional economies, in 2003 the South East was the fastest growing economy in the south and the second fastest growing regional economy in the UK (after the North East). The South East economy was the only regional economy in the south of the country that managed to avoid the impact of global slowdown (in particular in the first half of the year). This was largely due to its favourable industrial mix; lesser exposure of its financial sector to global economy and the return to manufacturing output growth. Strong consumer spending supported by public expenditure and construction-led activities also underpinned growth last year.



A recovery of manufacturing output underpinned by strong growth in public sector and construction driven activities were the main factors behind the strong performance of northern regions. In terms of growth rates of regional GVA, 2003 was the year of growth of the north, since all northern regions (apart from West Midlands) outperformed the UK average and most of the southern regions.

The latest estimates of regional GVA show that in the first and second quarters of 2004, the total growth in output was above its long run-trend. Total output expanded by 0.75% and 1.17% respectively (on previous quarters).

However, the latest survey evidence points towards slower growth in the third quarter of the year. Home sales and orders in the service sector have slowed since quarter two and remain at a level just below national average, while optimism prevails in the export market with accelerating sales and export orders:¹⁰

- +28% of service sector firms reported an increase in home sales, down 23 points from the previous quarter.

¹⁰ British Chambers of Commerce (2004)

- +19% of service sector firms reported an increase in home orders, down 20 points from the previous quarter.¹¹
- +25% of service sector firms reported an increase in export sales, up 16 points from the previous quarter.
- +11% of service sector firms reported an increase in export orders, up 5 points from the previous quarter.

It appears that several rises in interest rates over the past twelve months, combined with slower growth in public spending, are having an impact on the growth of the service sector of the South East economy.

The latest survey evidence from the manufacturing market points towards continuous revival in the manufacturing sector in the home market and deterioration in the export market:

- +28% of manufacturing sector firms reported an increase in home sales, up 3 points from the previous quarter.
- +13% of manufacturing sector firms reported an increase in home sales, up 4 points from the previous quarter.
- +12% of manufacturing sector firms reported an increase in exports sales, down 19 points from the previous quarter.
- +15% of manufacturing sector firms reported an increase in exports orders, down 9 points from the previous quarter.

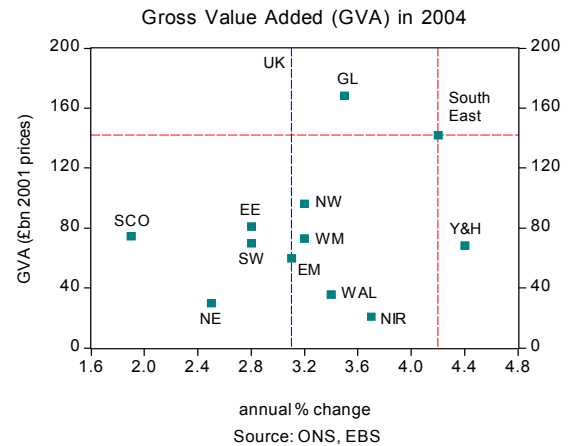
Strong growth in business investment appears as a major factor behind the strong performance of manufacturing sector in the home market. There appears to be some indications of some weakness in the strength of the export markets possibly due to the recent appreciation of the pound against the US dollar (and effectively against the major Asian currencies) and underperformance of the major EU economies (weak demand by the eurozone economies, which account for almost 60% of the South East export market for goods).

The British Chambers of Commerce (BCC) survey also shows that in spite of declining confidence amongst manufacturers and service sector firms in the third quarter, confidence still remains well above the national aggregate.

The latest regional estimates for 2004 by Experian Business Strategies (EBS) show that the potential slowdown in output growth in the third quarter is

¹¹ The percentage balance +/-% is the proportion of companies saying “up/increase” less than the proportion of companies saying “down/decrease”.

likely to remain just a blip and that we are likely too see a strong growth in output in the last quarter of the year. The South East economy is expected to have expanded by around 4.2 % in 2004 faster than any other regional economy in the country except Yorkshire and the Humber.¹²



What is also evident from the latest forecasts is the strong recovery of London’s economy, which was the UK’s worst performing regional economy in 2003.

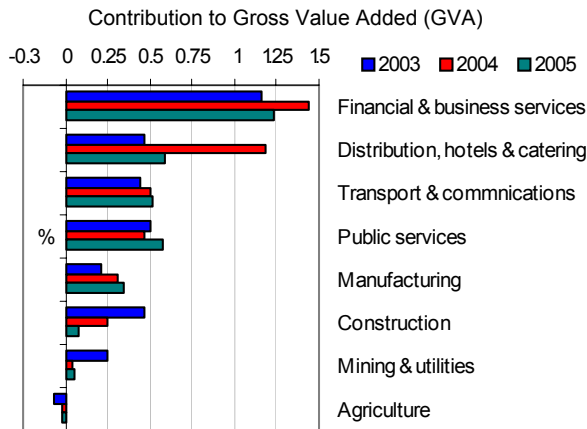
The growth of GVA in the South East is likely to be underpinned by the strong performance of financial and business services and distribution, hotels and catering sectors. Manufacturing and transport and communications are forecast to contribute a greater share to regional growth than last year, while output of construction and public services is likely to expand by somewhat slower rate

¹² Estimates of regional output and growth rates reported in this document will differ from those reported by the Office for National Statistics (ONS). Estimates of regional output by the ONS are only available in current prices, which implies that changes over time combine the effects of regional economic growth and inflation. Although the ONS have now produced regional consumer price indices (see Wingfield, D. Fenwick, D. and Smith, K, 2004) due to a lack of regional industry deflators the official real growth rates of regional GVA are not available.

The estimates of GVA reported in this document follow the methodology adopted by the ONS (based on income approach). Real estimates of GVA by broad industrial sector have been obtained by deflating nominal estimates of GVA by national industry deflators for broad industrial sectors. The final estimates of GVA by broad industrial sector had to be adjusted for commuting patterns since the official GVA by broad industrial sector is residence based.

Furthermore, the ONS has recently switched from fixed base weights (weights that change every five years) in its approach to estimate output to chain linked weights (weights that change every year), which should lead to more reliable estimates of national output. The estimates of national and regional output reported in this document are based on the new methodology, which is consistent to the one used by the ONS (for a summary of chain linking approach see Young, A. 1992).

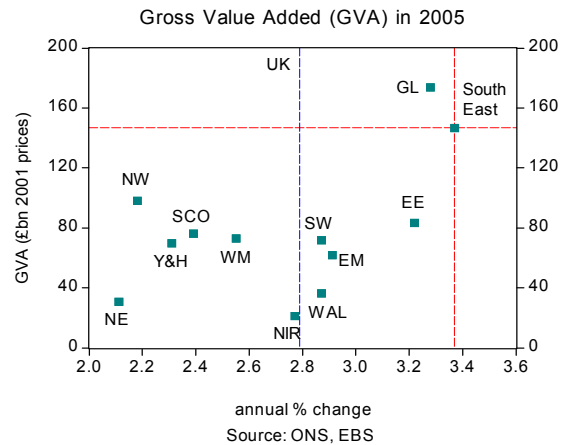
than last year. Agriculture, forestry and fishing is the only sector expected to contract output this year. Slower growth in consumer spending, underpinned by recent rises in interest rates and a less favourable outlook for housing market, is likely to lead to slower growth in service sector in 2005.



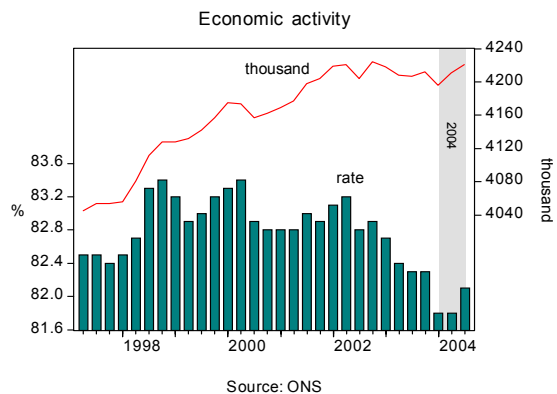
Source: SEEDA estimates derived from GVA data from EBS

In spite of expanding at a slower rate than in 2004, the financial & business services sector is forecast to be by far the greatest contributor to regional GVA next year, while distribution, hotels & catering and construction sectors are likely to bear the brunt of slower growth in consumer spending. Growth of real GVA in distribution, hotels & catering is forecast to halve in 2005 (from 6.5% this year to 3.2% in 2005), while growth of output in construction related activities is forecast to slow from 4.2% in 2004 to 1.4% in 2005. The revival of manufacturing is forecast to continue with total output expanding by 2.5% (marginally faster than in 2004). Growth is also forecast to be underpinned by stronger growth of output in transport & communications and public sector related activities.¹³

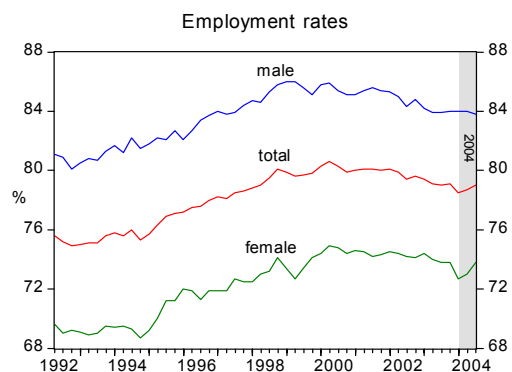
In spite of slower growth of consumer spending, the South East economy underpinned by stronger growth of business investment and exports is forecast to expand by around 3.4% in 2005. The South East economy is forecast to expand significantly faster than the UK economy or any other regional economy in 2005. Furthermore, the economies of London and East of England driven by strong growth in private sector activities are expected to expand strongly in 2005, thus ending the cycle of weak growth over the past couple of years.



The labour market remains tight, but not overly tight. Economic activity rates have recovered between July and September of 2004 after declining in the first half of the year. In the third quarter of the year, economic activity rates were 82.1%, the highest in the country.



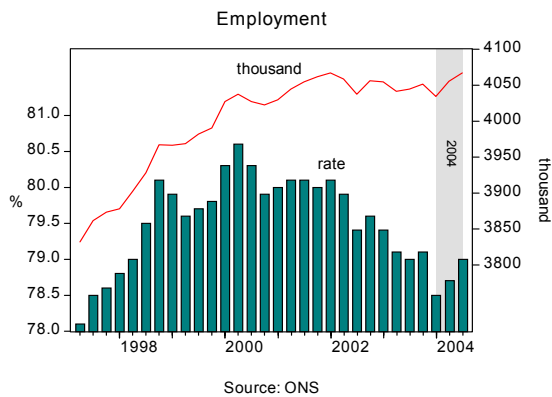
Employment rates followed a similar trend, recovering in the third quarter after a marginal decline in the first half of the year. In the third quarter of the year employment rate stood at 79%, significantly higher than national average and the second highest in the country (marginally below the East of England).



In the third quarter of the year, out of the total population of just over 8 million, over 4 million residents of the region were in employment.

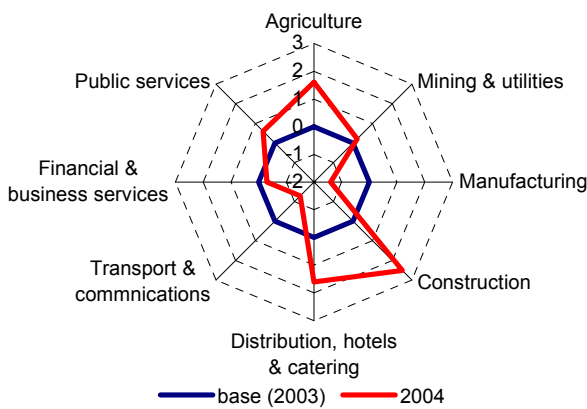
¹³ See Appendices B, C and D for detailed GVA and employment forecasts by industrial sectors.

Total full-time equivalent employment (FTE) is expected to have expanded by 0.4% in 2004 followed by strong growth of around 1% in 2005.¹⁴



The manufacturing sector is expected to have shed employment by around -1.4%, while financial & business services and transport & communications sectors are also expected to have marginally decreased employment in 2004. Growth in employment in 2004 is likely to have been driven by construction related activities, distribution, hotels & catering and the public sector.

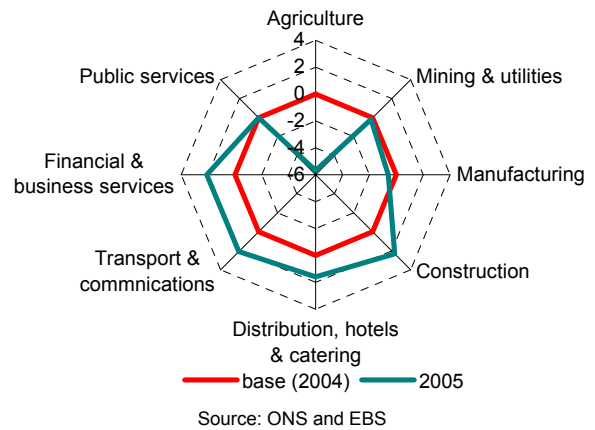
FTE employment growth (%), 2004



Employment growth in 2005 is expected to be driven by strong expansion in financial & business services sector and transport and communications. Employment in distribution, hotels & catering is expected to expand at a rate similar to 2004. Public sector employment is likely to remain relatively stable, while manufacturing will decrease employment by a modest 0.6%.

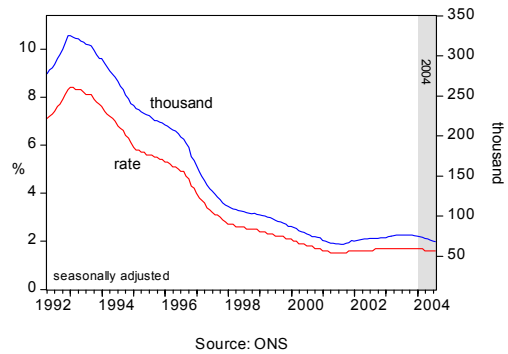
¹⁴ FTE = full time employees + self-employment + (0.4 * part-time employees), i.e. estimates of full-time equivalents assume that the hours worked by part-time employees are equivalent to 40% of a full-time employee.

FTE employment growth (%), 2005

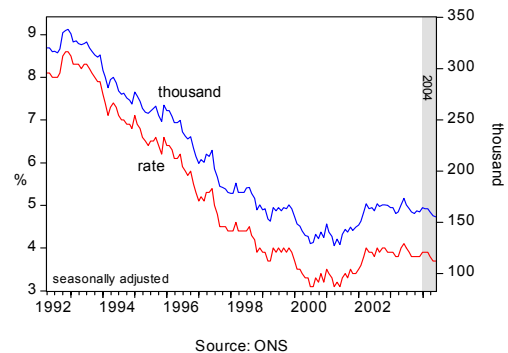


The claimant count and Labour Force Survey (LFS) measures of unemployment both declined in 2004. In the third quarter of the year there were 154,000 unemployed people in the region according to government's preferred measure (LFS) or 3.7% of economically active people of working age. This was the second highest absolute number in the country (after London). At the same time, number of people claiming Job Seekers Allowance (claimant count unemployment) decreased to below 70,000 or just 1.5% of economically active people of working age.

Claimant count unemployment

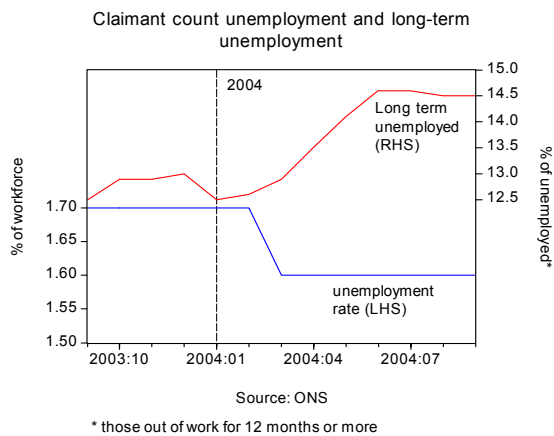


Labour Force Survey (LFS) unemployment



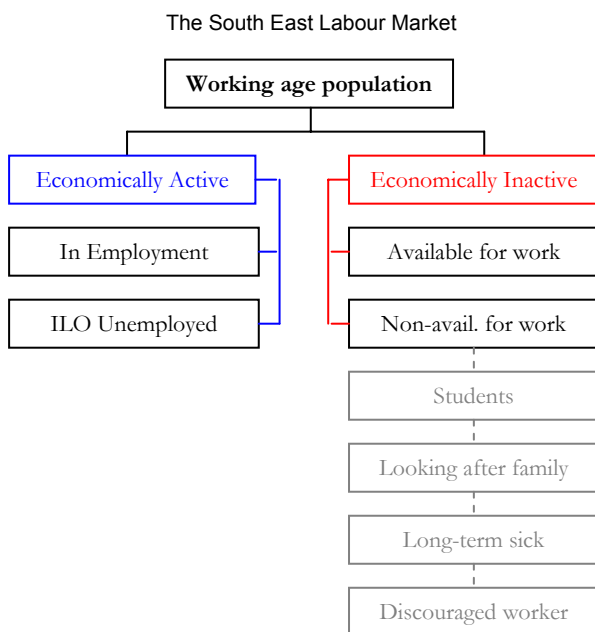
In 2005 the LFS unemployment is forecast to decline to just 3.1%, while claimant count unemployment is expected to remain at around 1.5% of economically active people of working age.

One area of concern is the rise of long term unemployment in the first half of the year. Long-term unemployment as a proportion of claimant count unemployment has risen from 12.5% at the beginning of the year to 14.5% in September of 2004.



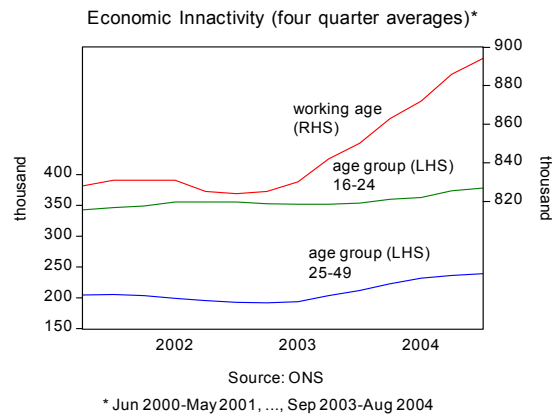
Employment rates at record high levels and unemployment rates at its lowest level for generation suggest that the labour market in the South East is healthy. Since full employment is the ultimate goal of social policy near full employment levels in the South East is an encouraging sign for national and regional policy-makers.

However, the regional labour market may not be as bright as it may first appear, since non-employment or economic inactivity is a significant issue, which often does not receive much attention. The latest data on economic inactivity shows a steady rise in number of people of working age in the region excluded from the labour market.¹⁵



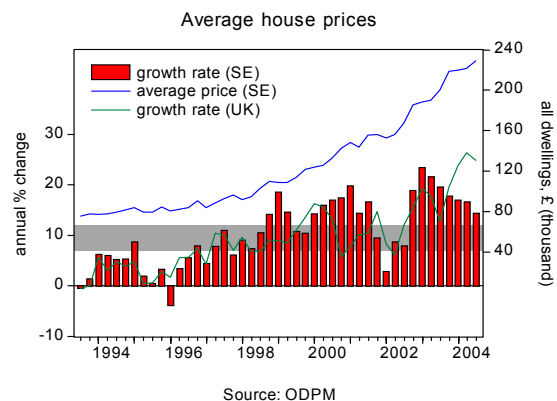
¹⁵ People of working age not actively seeking work

In the summer of 2004 there were 2.2 million economically inactive people in the region over the age of 16 (over 890,000 of those were people of working age).¹⁶ Disaggregating the inactive group of working age group reveals some interesting information. Over 260,000 of those people want a job and over 70,000 of those who want a job are available to start work in the next two weeks.¹⁷ This is greater number than there are unemployed people in the region claiming Job Seekers Allowance.



As already indicated over the past four years we have seen a steady increase in economically active population of working age. Although this is largely driven by the rise in student population there has also been an increase in 25-49 age group who would normally be expected to actively participate in the labour market.

Economically inactive population of working age does not actively participate in the labour market for a variety of reasons, which are beyond the scope of this paper. However, reducing economic inactivity ought to be central part of social policy to further rising employment and in particular employment in the most deprived areas in the region.



¹⁶ Working age population includes females belonging to 16-59 and males belonging to 16-64 age group.

¹⁷ The remaining number does not want a job and include students, long-term sick, those looking after family or home, discouraged workers etc.

House prices continued to grow in the first half of the year, while the second half of the year saw slower growth with some evidence of decline in house prices in some parts of the region. In spite of this, average house prices in the region are likely to grow by a single digit in 2004 and are forecast to marginally increase in 2005.

The importance of housing for the regional economy is well known and is further emphasised by the latest survey evidence.

According to the latest Survey of Regional Economic Trends 35% of companies in the South East reported the cost of housing as the most restrictive factor affecting business growth.¹⁸ This is affecting a higher proportion of the region's firms than in any other region including London. In addition to housing, inadequate transport infrastructure is affecting 25% of businesses in the region, alongside Wales the highest in the country.

Inter-regional disparities in growth rates of real output and unemployment over time

We are often reminded of the two-tier UK economy and the superior performance of financial and business service sector led economies of the south versus the economies of the north of England (characterised by greater share of manufacturing and public sector led activities in their output). The Government's Public Service Agreement (PSA) target relating to regional policy aims to "improve economic performance of all regions and reduce gaps in growth rates between regions".

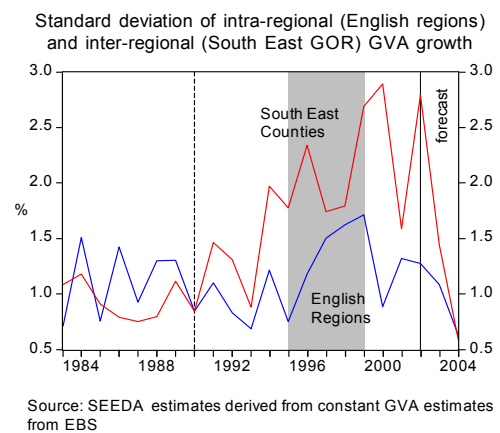
We use the standard deviation of growth rates of real output for nine English regions to assess any divergence or convergence between regional economies over the period from 1983 through to 2004.¹⁹ Standard deviation measures how far each region's rate of growth of real output differ from the UK average. A rising standard deviation implies divergence, while declining standard deviation implies convergence amongst English regions.

As indicated below, between 1995 and 1999 there appears to be some evidence of divergence between regional economies.

¹⁸ CBI, RDA, Welsh Development Agency and Scottish Enterprise (2004).

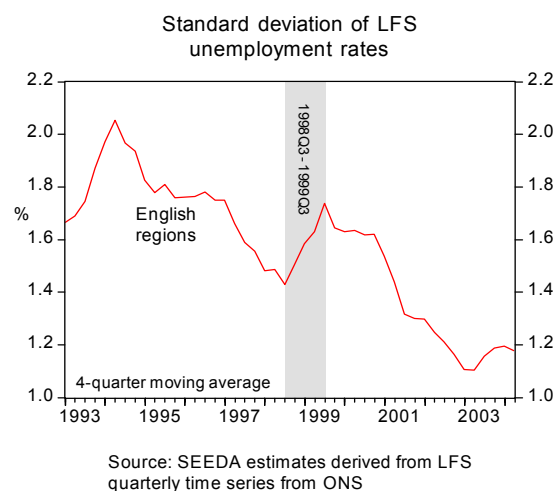
¹⁹ Due to a lack of official real GVA growth rates for English regions and the South East Counties, our estimates are based on the data sets provided by Experian Business Strategies as part of their Regional Planning Service (Autumn, 2004).

However, since 1999 and in particular over the past three years the standard deviation (as indicated by the shrinking figure) has declined, implying a convergence in growth rates.



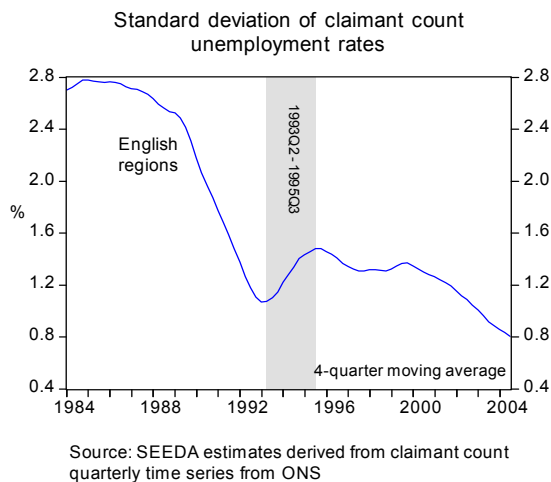
Disparities in growth rates between the South East counties reveal a rather different picture. Prior to the 1990s, those disparities were on average below disparities between English regions (on average less than 1% per annum). However, in the 1990s those disparities rose well above disparities between English regions. Although over the past couple of years we have seen some decline in disparities between the South East counties, they are still higher than inter-regional disparities.

If we take another widely watched economic variable – unemployment, the results are even more striking. The Government's preferred measure of unemployment (LFS unemployment) shows that the overall trend has been towards the convergence of unemployment rates over the past decade.²⁰

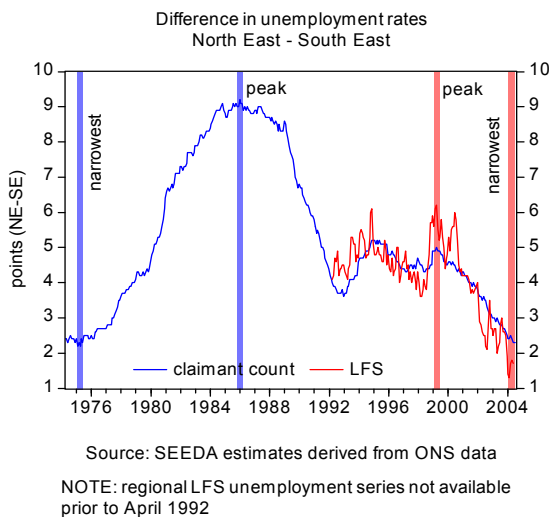


²⁰ The analysis has been constrained to the past decade due to unavailability of official regional LFS unemployment data.

Not surprisingly, the claimant count unemployment reveals similar trend with inter-regional unemployment rates converging over the past two decades (from their peak in 1985 to their narrowest in 2004).



In March 2004, the LFS unemployment rate in the North East was 5.2% against 3.9% in the South East, the smallest difference since the record began.²¹ In the 1990s, on average the difference in unemployment rates between these regions was 4.7 points. However between 2000 and 2004 it narrowed to 3.4 points.



The alternative measure of unemployment (the claimant count) shows that in August 2004 the difference in unemployment rates between the North East and the South East was the lowest since June of 1975. Furthermore, in the 1980s on average the difference in unemployment rates between these regions was 8 points, falling to 4.8 points in the 1990s and to just 3.5 between 2000 and 2004.

²¹ The peak was in April 1999 when the difference was 6.2 points (regional LFS unemployment data is not available prior to April 1992).

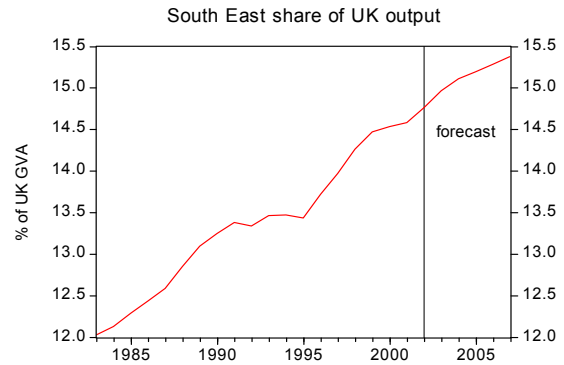
The aim of this section is not to argue that there are no differences between English regions, since in terms of GVA per capita and most of other indicators the South East as a whole (and other Southern regions) is well above the north of England. Instead, it points towards some evidence of narrowing disparities between English regions and growing disparities between the South East counties that need greater attention. We may argue that the UK economy is a two-speed economy, however the UK economy has been a two-speed economy for at least several decades. We could equally argue that the South East economy is also a two-speed economy with accelerating disparities emerging between its counties over the 1990s.

Appendix A: South East Forecast Summary

Output

Forecast Summary: Output					
	2003	2004	2005	2006	2007
GVA (million)	136.380	142.063	146.857	151.801	156.828
Growth rate (%)	3.3	4.2	3.4	3.4	3.3
% UK total	15.0	15.1	15.2	15.3	15.4
Productivity (£, thousand)	38.365	39.804	40.730	41.685	42.719
Growth rate (%)	2.2	3.8	2.3	2.3	2.5

Source: EBS

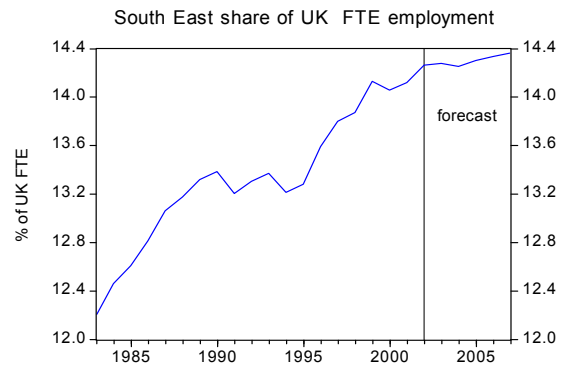


Source: ONS, EBS

Employment

Forecast Summary: Employment					
	2003	2004	2005	2006	2007
FTE (million)	3.555	3.569	3.606	3.642	3.671
Growth rate (%)	1.0	0.4	1.0	1.0	0.8
% UK total	14.3	14.3	14.3	14.3	14.4
Employees in employment (million)	3.643	3.648	3.683	3.721	3.753
Growth rate (%)	0.1	0.1	1.0	1.0	0.9
Self-employment (million)	0.624	0.634	0.642	0.649	0.654
Growth rate (%)	5.3	1.7	1.3	1.0	0.8
Total employment (million)	4.298	4.313	4.358	4.402	4.439
Growth rate (%)	0.9	0.4	1.0	1.0	0.8

Source: EBS

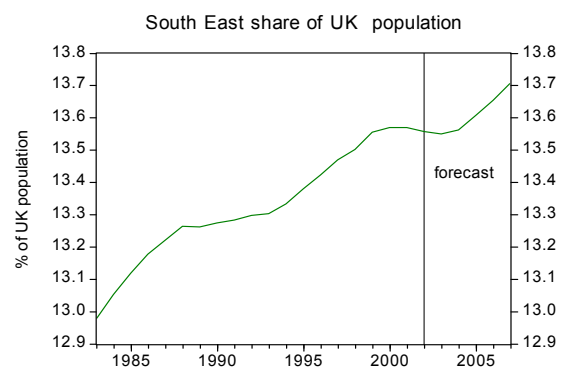


Source: ONS, EBS

Demographics & Unemployment

Forecast Summary: Demographics					
	2003	2004	2005	2006	2007
Total population (000s)	8075	8113	8172	8232	8294
Growth rate	0.3	0.5	0.7	0.7	0.8
% UK total	13.6	13.6	13.6	13.7	13.7
Working age population (000s)	4960	4987	5024	5062	5091
Growth rate	0.4	0.5	0.7	0.7	0.6
Forecast Summary: Unemployment					
Claimant count	76	70	66	53	53
Rate (%)	1.7	1.6	1.5	1.1	1.1
LFS unemployment	163	156	134	127	127
Rate (%)	3.9	3.7	3.1	2.9	2.9

Source: EBS



Source: ONS, EBS

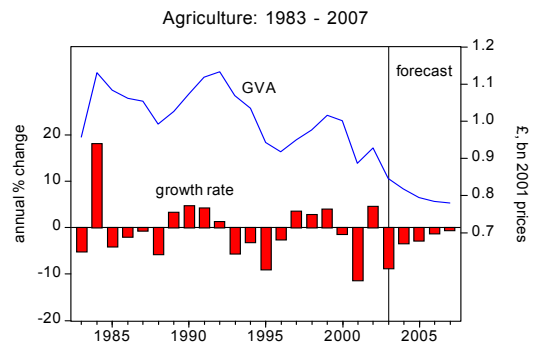
Note: GVA - expressed in 2001 prices, FTE – Full-time equivalent employment, Productivity – based on the ratio of total output to FTE employment, Productivity growth estimates based on Total Factor Productivity (TFP) are more reliable estimates, however due to a lack of appropriate data it is not possible to obtain those estimates at regional level, Claimant count – a measure of unemployment based on recipients of Job Seekers Allowance (JSA), LFS – broader measure of unemployment based on survey data.

Appendix B: Production - Output and Employment Forecasts

Agriculture

Forecast Summary: Output - Agriculture					
	2003	2004	2005	2006	2007
GVA	£846	£818	£795	£785	£780
Growth rate	-8.8	-3.4	-2.8	-1.3	-0.6
% Total	0.6	0.6	0.5	0.5	0.5
Productivity	£15.5	£14.7	£15.2	£15.5	£15.9
Productivity growth	-2.2	-4.9	3.1	2.1	2.5

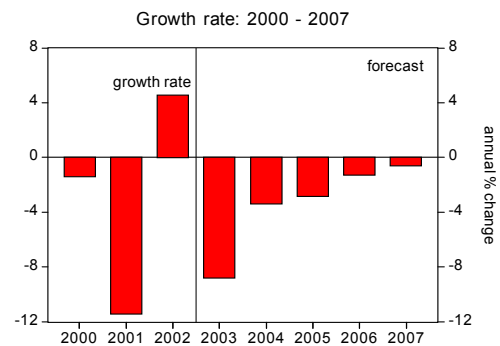
Source: EBS



Source: ONS, EBS

Forecast Summary: Employment - Agriculture					
	2003	2004	2005	2006	2007
FTE	54.8	55.6	52.5	50.7	49.2
Growth rate	-6.7	1.6	-5.7	-3.3	-3.0
Share of FTE	1.5	1.6	1.5	1.4	1.3
Employees in employment	40.4	39.0	37.5	36.3	35.2
Self-employment	19.1	21.6	19.8	19.2	18.7
Total employment	59.5	60.6	57.3	55.5	53.9
Share of total employment	1.4	1.4	1.3	1.3	1.2

Source: EBS

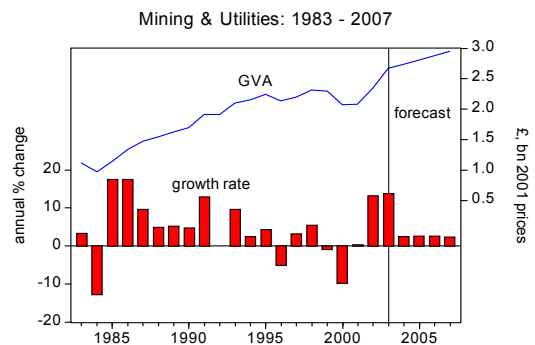


Source: ONS, EBS

Mining & Utilities

Forecast Summary: Output - Mining & Utilities					
	2003	2004	2005	2006	2007
GVA	£2,675	£2,739	£2,810	£2,881	£2,947
Growth rate	13.7	2.4	2.6	2.5	2.3
% Total	2.0	1.9	1.9	1.9	1.9
Productivity	£136.0	£138.8	£142.7	£149.0	£155.5
Productivity growth	4.3	2.1	2.8	4.4	4.4

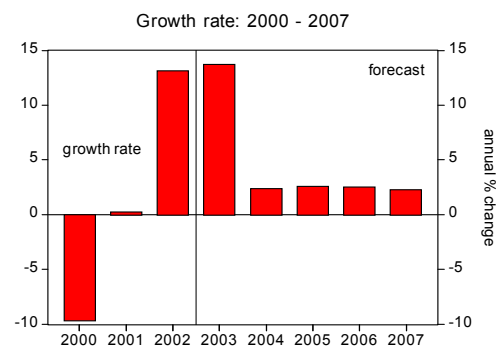
Source: EBS



Source: ONS, EBS

Forecast Summary: Employment - Mining & Utilities					
	2003	2004	2005	2006	2007
FTE	19.7	19.7	19.7	19.3	18.9
Growth rate	9.0	0.2	-0.2	-1.8	-2.0
Share of FTE	0.6	0.6	0.5	0.5	0.5
Employees in employment	19.4	19.3	19.1	18.8	18.4
Self-employment	1.6	1.5	1.7	1.7	1.7
Total employment	21.0	20.9	20.8	20.5	20.1
Share of total employment	0.5	0.5	0.5	0.5	0.5

Source: EBS

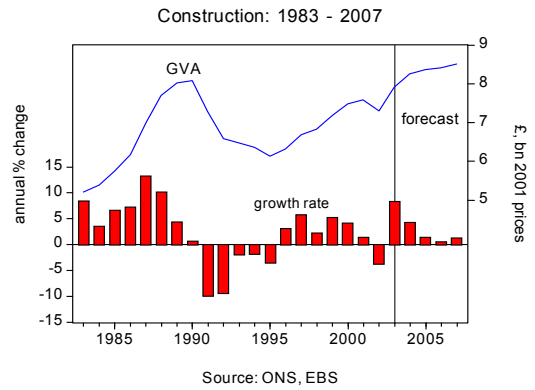


Source: ONS, EBS

Construction

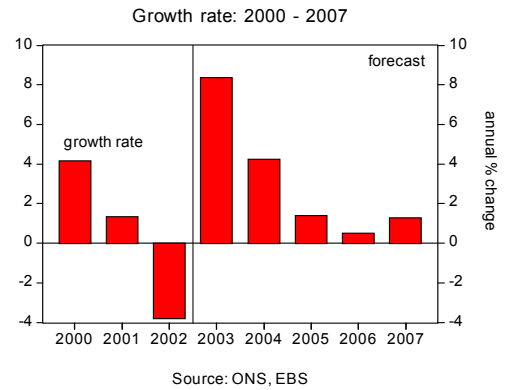
Forecast Summary: Output - Construction					
	2003	2004	2005	2006	2007
GVA	£7,912	£8,247	£8,361	£8,403	£8,512
Growth rate	8.4	4.2	1.4	0.5	1.3
% Total	5.8	5.8	5.7	5.5	5.4
Productivity	£28.5	£29.0	£28.7	£28.9	£29.6
Productivity growth	5.6	1.7	-0.9	0.9	2.3

Source: EBS



Forecast Summary: Employment - Construction					
	2003	2004	2005	2006	2007
FTE	277.9	284.8	291.5	290.4	287.6
Growth rate	2.6	2.5	2.3	-0.4	-0.9
Share of FTE	7.8	8.0	8.1	8.0	7.8
Employees in employment	144.5	150.6	149.1	146.2	142.2
Self-employment	140.9	141.6	149.6	151.2	152.1
Total employment	285.4	292.2	298.7	297.3	294.3
Share of total employment	6.6	6.8	6.9	6.8	6.6

Source: EBS

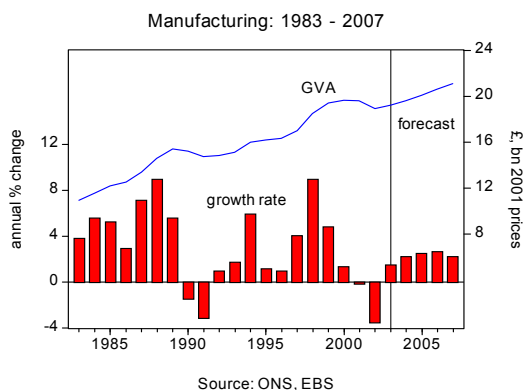


Appendix C: Manufacturing - Output and Employment Forecasts

Manufacturing (Total)

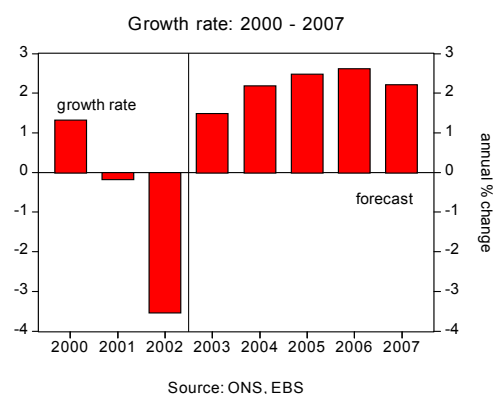
Forecast Summary: Output - Manufacturing					
	2003	2004	2005	2006	2007
GVA	19,186	19,605	20,089	20,616	21,072
Growth rate	1.5	2.2	2.5	2.6	2.2
% Total	13.9	13.5	13.3	13.2	13.1
Productivity	£47.0	£48.7	£50.2	£51.4	£52.6
Productivity growth	4.1	3.6	3.1	2.4	2.4

Source: EBS



Forecast Summary: Employment - Manufacturing					
	2003	2004	2005	2006	2007
FTE	408.5	402.7	400.2	401.1	400.5
Growth rate	-2.5	-1.4	-0.6	0.2	-0.1
Share of FTE	11.5	11.3	11.1	11.0	10.9
Employees in employment	381.3	373.1	371.2	372.2	371.7
Self-employment	43.0	46.5	48.9	48.2	48.0
Total employment	424.2	419.6	420.1	420.4	419.7
Share of total employment	9.9	9.7	9.6	9.5	9.5

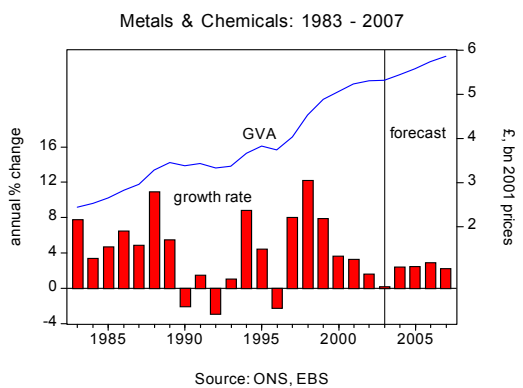
Source: EBS



Metals & Chemicals

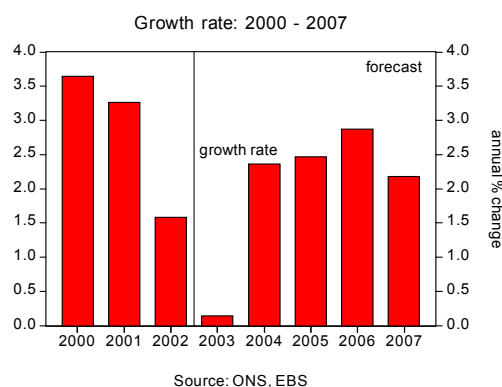
Forecast Summary: Output - Metals & Chemicals					
	2003	2004	2005	2006	2007
GVA	£5,316	£5,441	£5,575	£5,736	£5,861
Growth rate	0.1	2.4	2.5	2.9	2.2
% Total	28.1	28.4	28.4	28.6	28.4
Productivity	£54.7	£58.8	£59.8	£61.0	£62.7
Productivity growth	2.7	7.6	1.6	2.0	2.8

Source: EBS



Forecast Summary: Employment - Metals & Chemicals					
	2003	2004	2005	2006	2007
FTE	97.2	92.5	93.2	94.0	93.5
Growth rate	-2.5	-4.9	0.8	0.8	-0.6
Share of FTE	23.8	23.0	23.3	23.4	23.3
Employees in employment	88.7	85.9	86.4	87.1	86.6
Self-employment	12.2	10.2	10.5	10.5	10.4
Total employment	101.0	96.0	96.9	97.7	97.1
Share of total employment	23.8	22.9	23.1	23.2	23.1

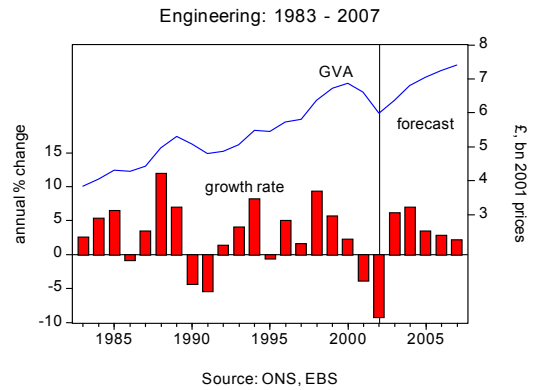
Source: EBS



Engineering

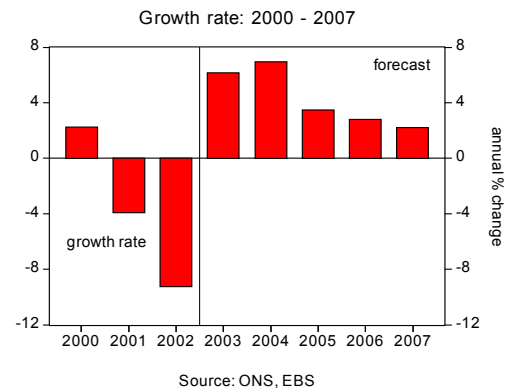
Forecast Summary: Output - Engineering					
	2003	2004	2005	2006	2007
GVA	£6,361	£6,804	£7,041	£7,239	£7,399
Growth rate	6.1	7.0	3.5	2.8	2.2
% Total	33.7	35.5	35.9	36.0	35.9
Productivity	£41.7	£45.4	£48.0	£50.0	£51.5
Productivity growth	10.0	8.9	5.7	4.1	3.1

Source: EBS



Forecast Summary: Employment - Engineering					
	2003	2004	2005	2006	2007
FTE	152.5	149.8	146.6	144.8	143.5
Growth rate	-3.5	-1.8	-2.1	-1.2	-0.9
Share of FTE	37.3	37.2	36.6	36.1	35.8
Employees in employment	146.6	144.0	140.8	139.1	138.0
Self-employment	10.2	10.4	10.2	10.0	9.9
Total employment	156.9	154.4	151.0	149.1	147.8
Share of total employment	37.0	36.8	35.9	35.5	35.2

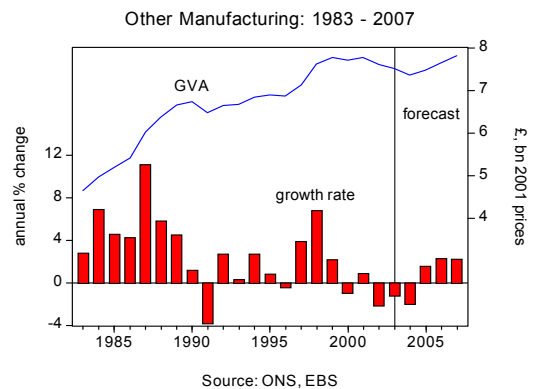
Source: EBS



Other Manufacturing

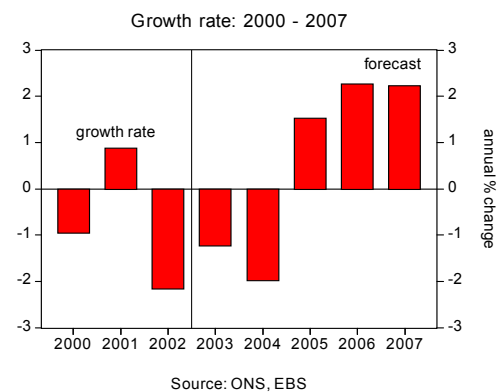
Forecast Summary: Output - Other Manufacturing					
	2003	2004	2005	2006	2007
GVA	£7,509	£7,360	£7,473	£7,642	£7,813
Growth rate	-1.2	-2.0	1.5	2.3	2.2
% Total	39.7	38.4	38.1	38.0	37.9
Productivity	£47.3	£45.9	£46.6	£47.1	£47.8
Productivity growth	0.4	-3.0	1.6	1.1	1.5

Source: EBS



Forecast Summary: Employment - Other Manufacturing					
	2003	2004	2005	2006	2007
FTE	158.7	160.5	160.4	162.3	163.5
Growth rate	-1.6	1.1	0.0	1.2	0.7
Share of FTE	38.9	39.8	40.1	40.5	40.8
Employees in employment	145.9	143.2	144.0	145.9	147.1
Self-employment	24.0	28.4	27.4	27.5	27.5
Total employment	169.9	171.6	171.4	173.4	174.6
Share of total employment	40.0	40.9	40.8	41.3	41.6

Source: EBS

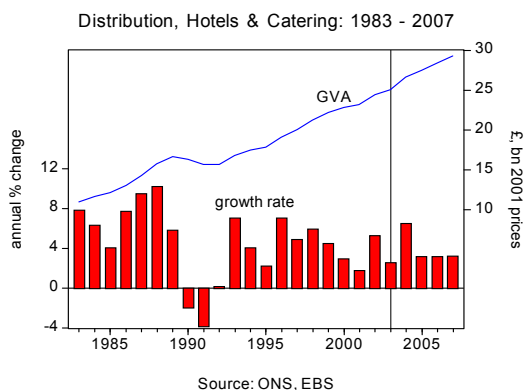


Appendix D: Services - Output and Employment Forecasts

Distribution, Hotels & Catering

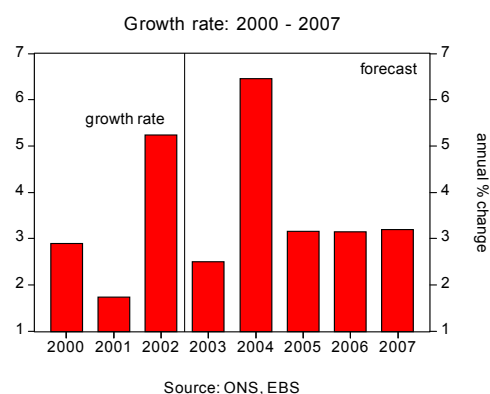
Forecast Summary: Output - Distribution, Hotels & Catering					
	2003	2004	2005	2006	2007
GVA	£25,018	£26,634	£27,474	£28,340	£29,244
Growth rate	2.5	6.5	3.2	3.2	3.2
% Total	18.3	18.7	18.7	18.7	18.6
Productivity	£32.2	£33.7	£34.2	£34.8	£35.6
Productivity growth	2.3	4.8	1.5	1.7	2.1

Source: EBS



Forecast Summary: Employment - Distribution, Hotels & Catering					
	2003	2004	2005	2006	2007
FTE	777.1	789.7	802.7	814.0	822.3
Growth rate	0.2	1.6	1.6	1.4	1.0
Share of FTE	21.9	22.1	22.3	22.4	22.4
Employees in employment	951	962	982	1,001	1,015
Self-employment	83.6	89.2	87.8	86.5	85.0
Total employment	1,034.4	1,050.7	1,070.2	1,087.3	1,100.0
Share of total employment	24.1	24.4	24.6	24.7	24.8

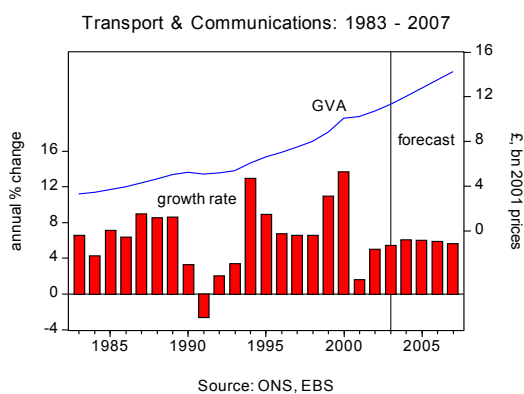
Source: EBS



Transport & Communications

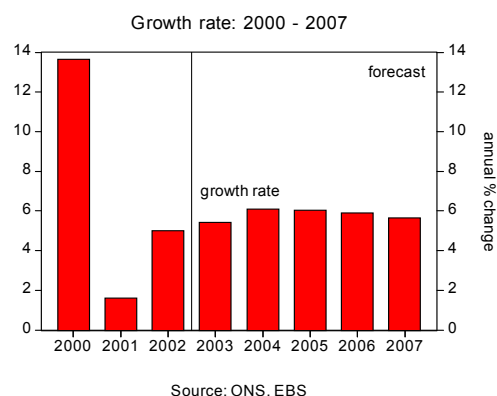
Forecast Summary: Output - Transport & Communications					
	2003	2004	2005	2006	2007
GVA	£11,325	£12,014	£12,738	£13,490	£14,251
Growth rate	5.4	6.1	6.0	5.9	5.6
% Total	8.3	8.5	8.7	8.9	9.1
Productivity	£45.8	£49.2	£51.1	£53.3	£55.5
Productivity growth	1.9	7.4	3.8	4.2	4.3

Source: EBS



Forecast Summary: Employment - Transport & Communications					
	2003	2004	2005	2006	2007
FTE	247.3	244.1	249.3	253.3	256.6
Growth rate	3.4	-1.3	2.1	1.6	1.3
Share of FTE	7.0	6.8	6.9	7.0	7.0
Employees in employment	231.8	228.5	231.7	234.9	237.9
Self-employment	37.2	36.4	38.9	40.2	41.1
Total employment	269.0	264.9	270.5	275.1	279.0
Share of total employment	6.3	6.1	6.2	6.2	6.3

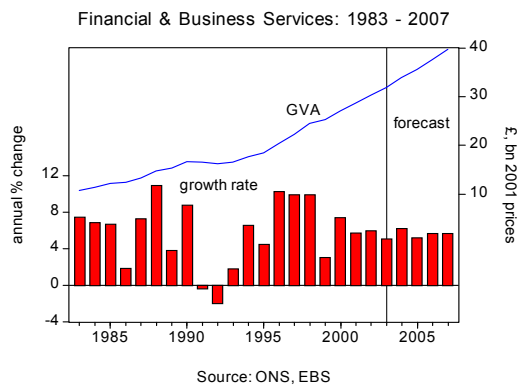
Source: EBS



Financial & Business Services

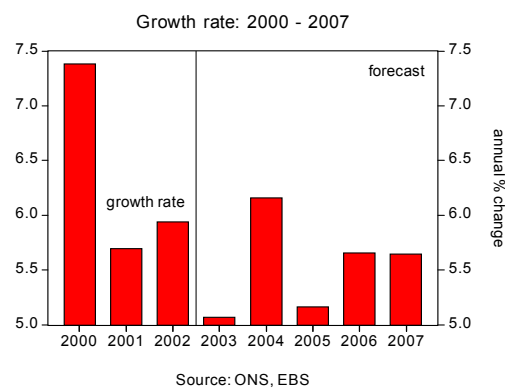
Forecast Summary: Output - Financial & Business Services					
	2003	2004	2005	2006	2007
GVA	£31,902	£33,866	£35,615	£37,629	£39,753
Growth rate	5.1	6.2	5.2	5.7	5.6
% Total	23.4	23.8	24.3	24.8	25.3
Productivity	£37.4	£39.9	£41.1	£42.1	£43.2
Productivity growth	5.0	6.5	3.0	2.4	2.7

Source: EBS



Forecast Summary: Employment - Financial & Business Services					
	2003	2004	2005	2006	2007
FTE	852.1	849.3	867.1	894.5	920.6
Growth rate	0.1	-0.3	2.1	3.2	2.9
Share of FTE	24.0	23.8	24.0	24.6	25.1
Employees in employment	845.5	835.0	853.0	878.0	901.8
Self-employment	138.8	143.3	144.2	150.2	155.8
Total employment	984	978	997	1,028	1,058
Share of total employment	22.9	22.7	22.9	23.4	23.8

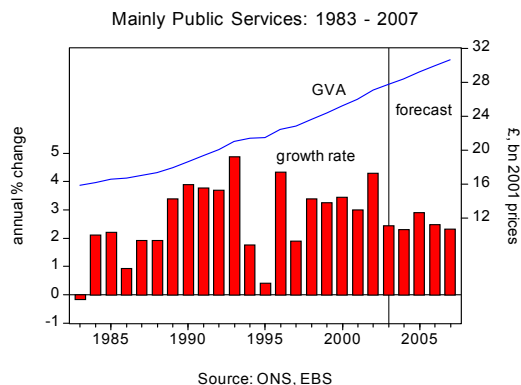
Source: EBS



Mainly Public Services

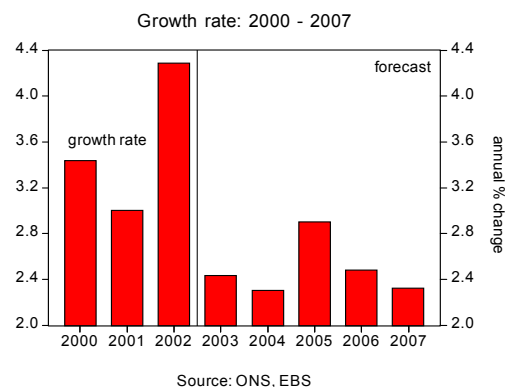
Forecast Summary: Output - Public Services					
	2003	2004	2005	2006	2007
GVA	£27,737	£28,375	£29,199	£29,924	£30,618
Growth rate	2.4	2.3	2.9	2.5	2.3
% Total	20.3	20.0	19.9	19.7	19.5
Productivity	£30.3	£30.8	£31.7	£32.7	£33.5
Productivity growth	-1.2	1.7	2.9	3.0	2.6

Source: EBS



Forecast Summary: Employment - Public Services					
	2003	2004	2005	2006	2007
FTE	914.9	920.5	920.4	916.2	913.5
Growth rate	3.7	0.6	0.0	-0.5	-0.3
Share of FTE	25.7	25.8	25.5	25.2	24.9
Employees in employment	1,027	1,038	1,037	1,032	1,029
Self-employment	155.6	151.2	152.2	151.8	151.5
Total employment	1,183	1,189	1,189	1,184	1,181
Share of total employment	27.5	27.6	27.3	26.9	26.6

Source: EBS



Appendix E: Standard Industrial Classification (SIC) 1992

Industry	Section	Sub-section	Group
<i>Agriculture, Forestry & Fishing</i>	<i>A & B</i>		<i>01,03,05</i>
<i>Mining & Utilities</i>	<i>C & E</i>		
Mining exc. the extraction of Oil & Gas	C	CA, CB	10,12,13,14
Electricity & Water Supply	E		40,41
<i>Manufacturing</i>	<i>D</i>		<i>15 - 37</i>
<i>Metals & Chemicals</i>			
Fuel Processing		DF	23
Metals manufacture & Metal Products		DJ	27,28
Minerals		DI	26
Chemicals & Man -Made Fibres		DG	24
<i>Engineering</i>			
Mechanical Engineering		DK	29
Electrical Engineering		DL	30,31,32,33
Transport Equipment		DM	34,35
<i>Other Manufacturing</i>			
Food, Drink & Tobacco		DA	15,16
Textiles & Clothing		DB, DC	17,18,19
Timber & Wooden Furniture		DD	20
Paper, Printing & Publishing		DE	21,22
Rubber & Plastics		DH	25
“Other” Other Manufacturing		DN	36,37
<i>Construction</i>	<i>F</i>		<i>45</i>
<i>Distribution, Hotels & Catering</i>			
Retailing	G		52
Other Distribution, Hotels & Catering	G, H		50,51,55
<i>Transport & Communications</i>	<i>I</i>		
Transport	I		60,61,62,63
Communications	I		64
<i>Financial & Business Services</i>	<i>J - K</i>		
Financial Services	J		65,66,67
Business Services	K		72,74
Property, Renting and Research	K		70,71,73
<i>Public Services</i>	<i>L - P</i>		
Public Administration & Defence	L		75
Education & Health	M, N		80,85
“Other” Other Services	O, P		90,91,92,93,95

Source: ONS

Appendix F: Bibliography

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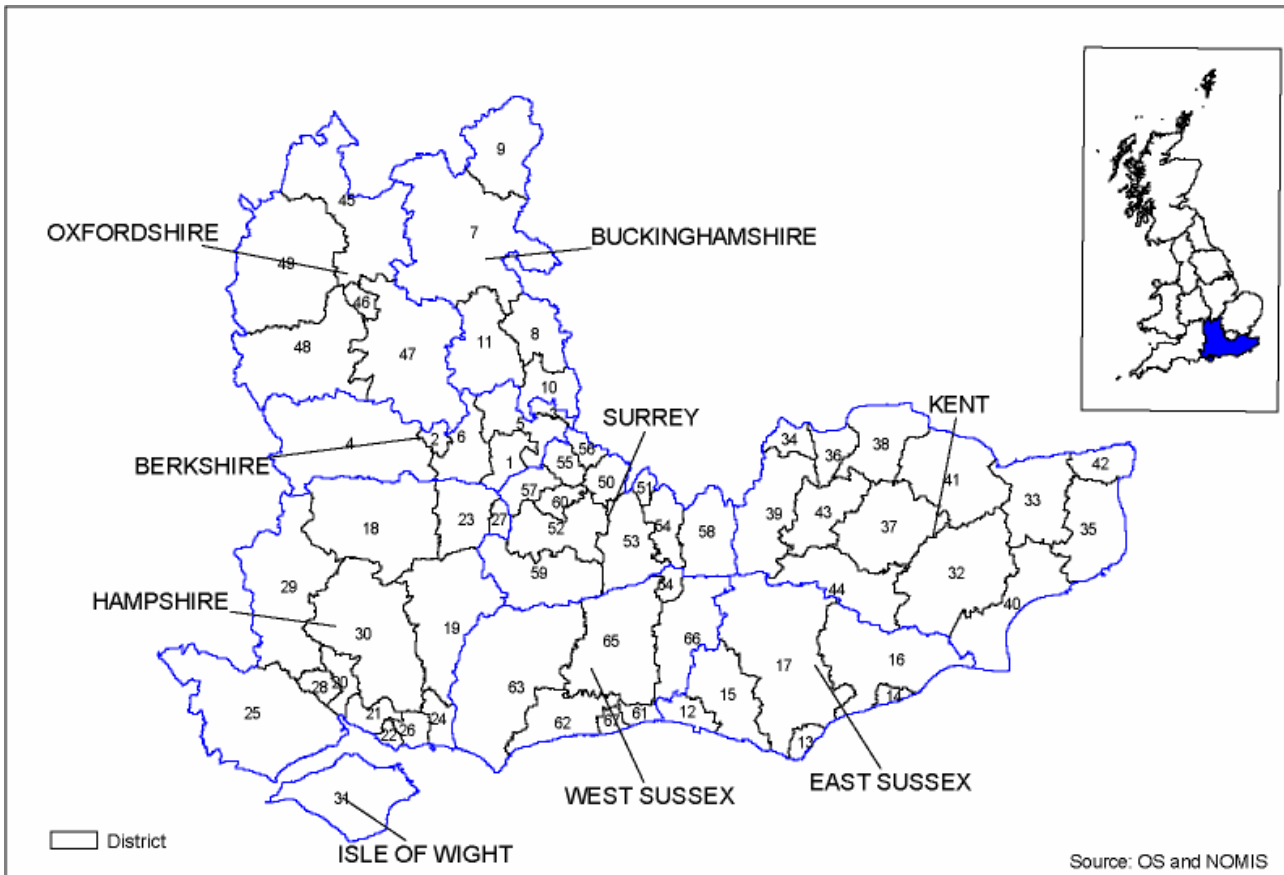
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Appendix G: South East England and its Sub-Regions²²



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Berkshire	Surrey	25	New Forest	42	Thanet
1 Bracknell Forest	50 Elmbridge	26	Portsmouth	43	Tonbridge and Malling
2 Reading	51 Epsom and Ewell	27	Rushmoor	44	Tunbridge Wells
3 Slough	52 Guildford	28	Southampton		
4 West Berkshire	53 Mole Valley	29	Test Valley	East Sussex	
5 Windsor and Maidenhead	54 Reigate and Banstead	30	Winchester	12	Brighton and Hove
6 Wokingham	55 Runnymede			13	Eastbourne
	56 Spelthorne		Isle of Wight	14	Hastings
Buckinghamshire	57 Surrey Heath	31	Isle of Wight	15	Lewes
7 Aylesbury Vale	58 Tandridge			16	Rother
8 Chiltern	59 Waverley		Kent	17	Wealden
9 Milton Keynes	60 Woking		32		
10 South Buckinghamshire			33	West Sussex	
11 Wycombe	Hampshire		34	61	Adur
	18 Basingstoke and Deane		35	62	Arun
Oxfordshire	19 East Hampshire		36	63	Chichester
45 Cherwell	20 Eastleigh		37	64	Crawley
46 Oxford	21 Fareham		38	65	Horsham
47 South Oxfordshire	22 Gosport		39	66	Mid Sussex
48 Vale of White Horse	23 Hart		40	67	Worthing
49 West Oxfordshire	24 Havant		41		

²² Forecasts reported in this document were largely derived from Experian Business Strategies' (EBS) UK and regional econometric models (as part of the Regional Planning Service) and do not necessarily represent the view of the South East England Development Agency (SEEDA).

The South East England Development Agency is not responsible for any loss incurred as a result of views expressed in this document.



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