QUARTERLY

STATE OF THE TYNE & WEAR ECONOMY REPORT
Summer 2010

Job changes covering Apr to Jun 2010
Local News to June
Bank Lending Latest BoE Report July

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KEY POINTS

This report covers the 3 months to end-June.

UK Economic Overview

UK economic growth accelerated sharply in **Q2 (Apr-Jun),** to 1.1%, about 1½ times its normal rate (ONS' provisional est.).

This is surprisingly fast growth given that;
a) **bank lending** growth continues to be **very weak**. It is **under 1%pa** for both mortgage debt and consumer credit. Businesses are continuing to repay debt to the banks.
b) **living standards are *falling* sharply** (by **about 3%pa).** As measured by the **RPI,** annual inflation has **remained** around **5% since April.** **Important note:** The Bank of England expects CPI inflation to subside in 2010's second half

The **budget** set out a trajectory for cuts in public spending of £70bn (or about 12%) over five years, with tax rises as well of about £30bn. This represents a **huge tightening of about 7% of GDP** (taking spending out of the economy). Interest rates look set to be kept low for longer than previously thought. [The context for this risk was outlined in the spring feature on the 'Public Debt Trap'.] The Chancellor needs a "Plan B" in case economic growth is significantly weaker than forecast and needed.

Local Economy

Local business indicators (for TW) do not corroborate the strong UK growth [possibly because the survey was in June]. They **show a marked weakening in Q2**, with export demand down and UK demand flat.

Unemployment

ONS' estimate of **UK unemployment** (the **official definition from LFS**) *fell* (for the first time since the recession began), down 34,000 to 2.47m in the 3 months to May. Thus the rate has fallen 0.1pp from the previous 3 months to 7.8%. Caution: these LFS ests. can be volatile.

UK claimant unemployment has continued to fall since **the autumn** months (except around January)**: Claimant unemployment *fell* 20,800 in June** on the seasonally adjusted series. The same variable has also now fallen by 170,000 since Nov (1.630m) to 1.46m.

In **Tyne & Wear, claimant unemployment** fell in most months since October and in June was **lower by nearly 2,900 from a year earlier** at 34,780. Caution: TW series is *not* seasonally adjusted.

TW's fall in claimant unemployment in the year to June was **led by Sunderland**, **with a fall of over 1,300 (-12.4%).** All other Districts fell by between about 3-8%. The weakest falls have been in Newcastle (-5.1%, -449) and South Tyneside (-3.5%, -223). The other two were close to the TW and UK falls; Gateshead (-7.7%, -458) and North Tyneside (-7.3%, -427).
Caution: there is no seasonally adjusted (SA) series by ONS for TW claimant unemployment count.

Global Context

The Eurozone crisis[1] stabilised after the €750bn support package in early May. Private markets for govt bonds were not supplying new credit to govts in southern Europe for two months. In July, some private funding has returned, even to Greece.
UK manufacturing's slowing growth in June was attributed to slowing in the Eurozone – by CIPS[2].

The NE's goods exports in Q1 **dipped 8% on the previous quarter (down up £221m[3]).** This follows very strong growth of 17% in Q4 (double the 8% rise in Q3). Remarkably, exports to all regions fell except to the EU (up 2.6%). Exports to N. America dropped by 35%, to the lowest level since 2007. Caution: it may be an effect from importers building their stocks in Q4. (Graph on p3).

Local Job Gains

The four largest gains were:
Nissan (400 temps), in response to rising demand for the Qashqai and 24-h working.
Longbenton Foods 150 (recovery after the 2009 fire).
Insurethebox (150) at Quorum Business Park.
Crowne Plaza Hotel (100+) in Newcastle also with a boutique hotel. Both are by InterContinental Hotels.

Local Job Losses

The main job losses were at;
Northern Rock (-650). These are estimated by TWRI to be -325 at Newcastle and -325 at Sunderland.
Garlands (-178) closure of the South Tyneside call centre.
Siemens [Trench UK] (-96). Closure of the Trench plant only.

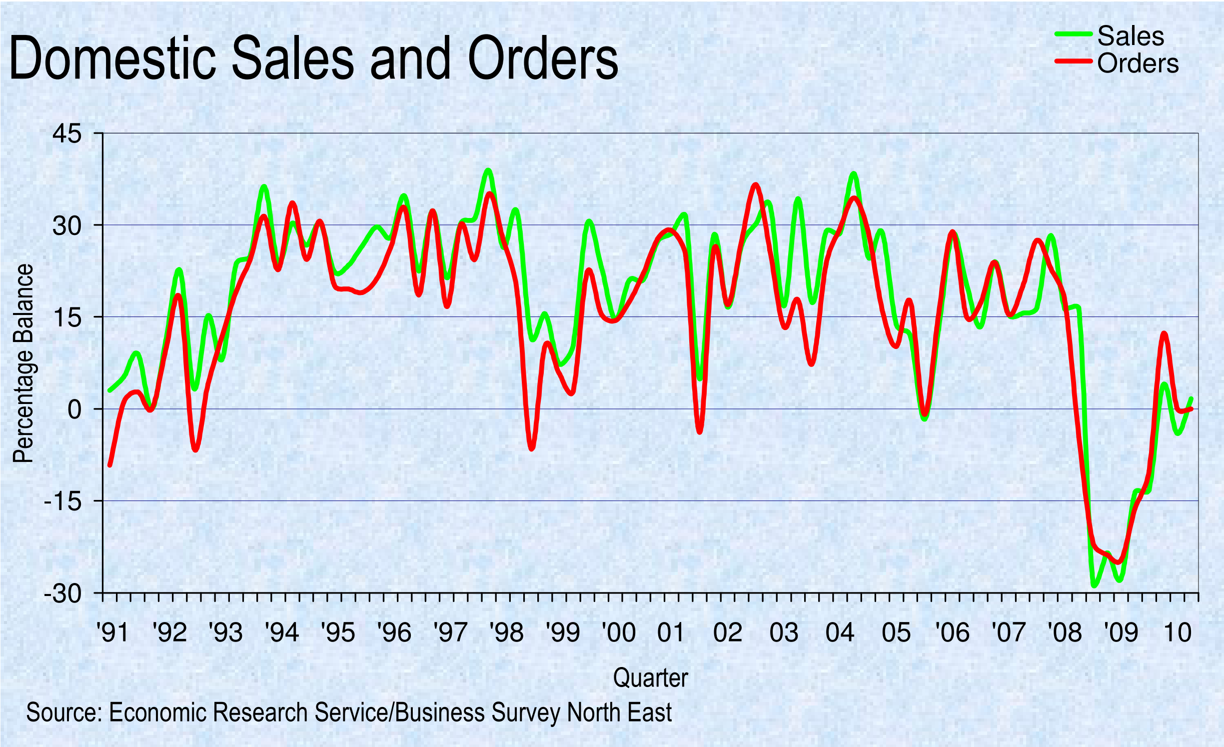
Date: 30th July 2010.

[1] Shorthand for the crisis of govt debt and the banking system in the countries which use the Euro.
[2] CIPS is the Chartered Institute of Purchasing & Supply.
[3] This dip is worth over 1% of NE GDP.

TYNE & WEAR ECONOMY

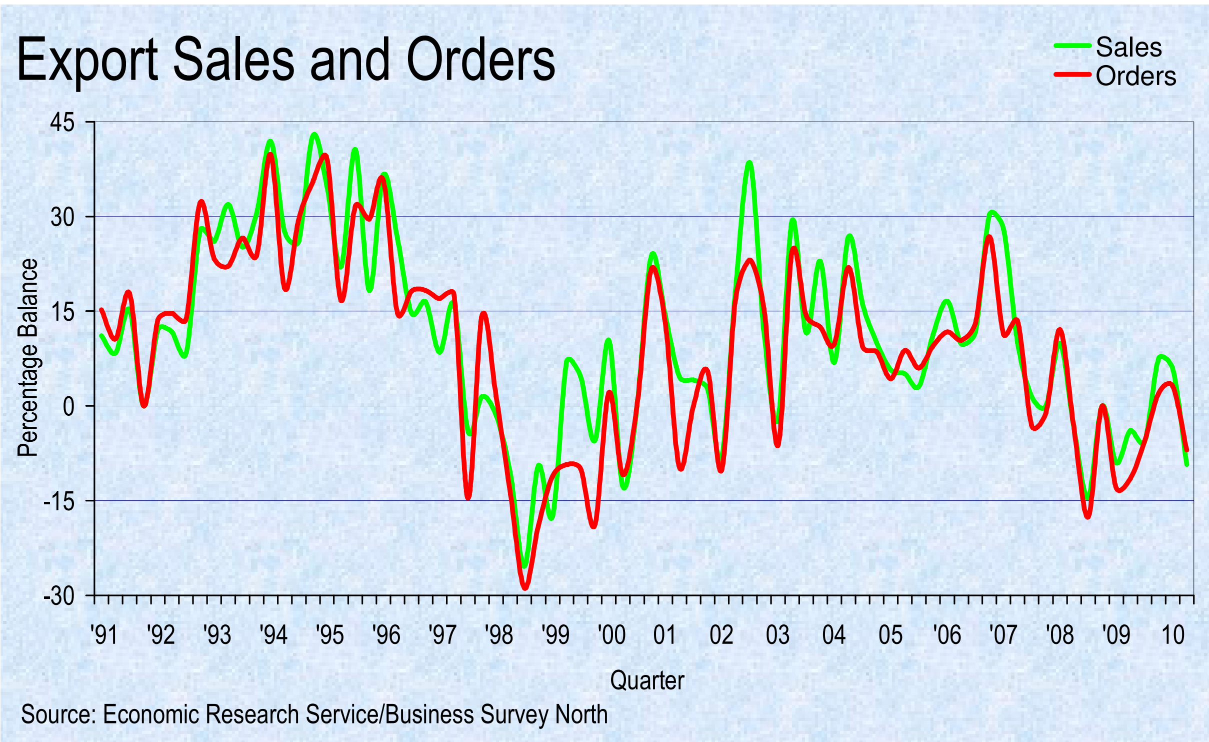
1. Indicators of Demand (in TW):

In the second of 2010, TW firms reported domestic demand (UK customers) virtually stopped growing, with sales up very slightly (net balance under 2%). Growth of orders was zero.



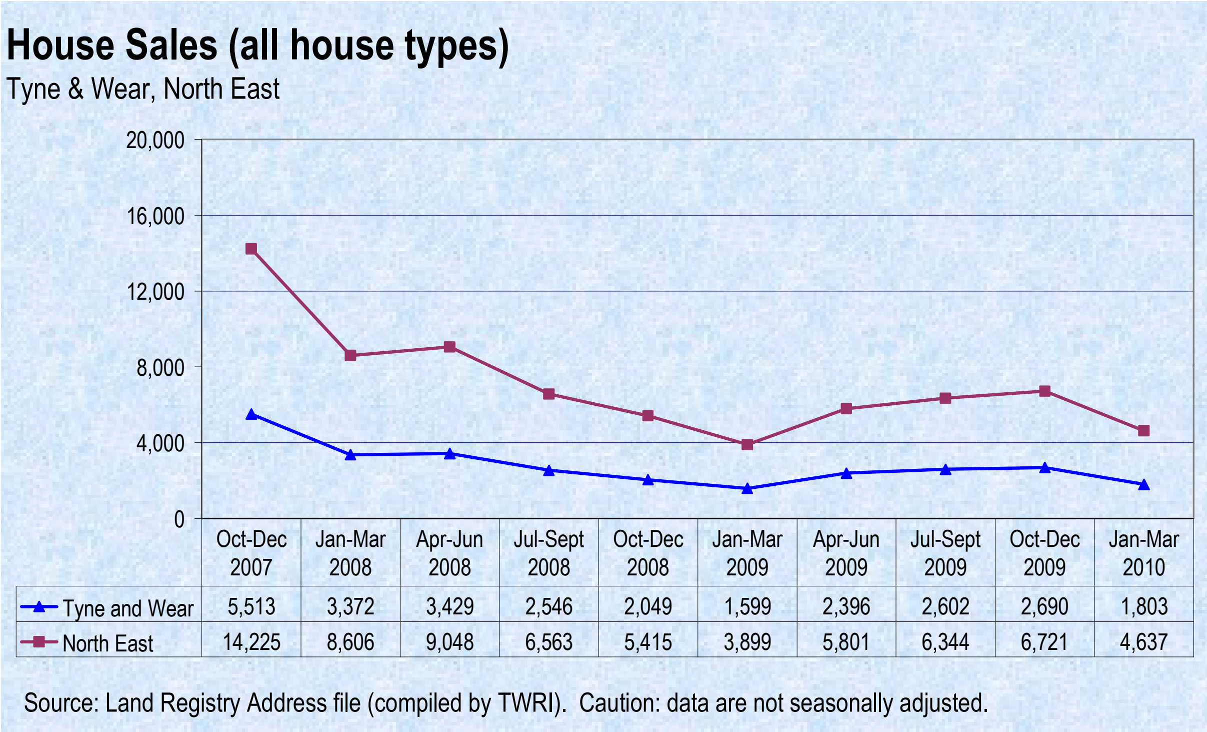
Note: these indicators of demand are from firms in Tyne & Wear (only).

Export demand dropped in Q2, with orders on a balance of -7%.



2. Housing Market

In Q1 'winter' 2010, house sales were up on the corresponding start of 2009 (TW up 13%, and NE up 19%)(chart below). Compared with 3 years earlier (in 2007) sales were still hugely down[4]. Caution: sales are highly seasonal, in 2007 TW sales rose in the spring, falling 2% in the summer.

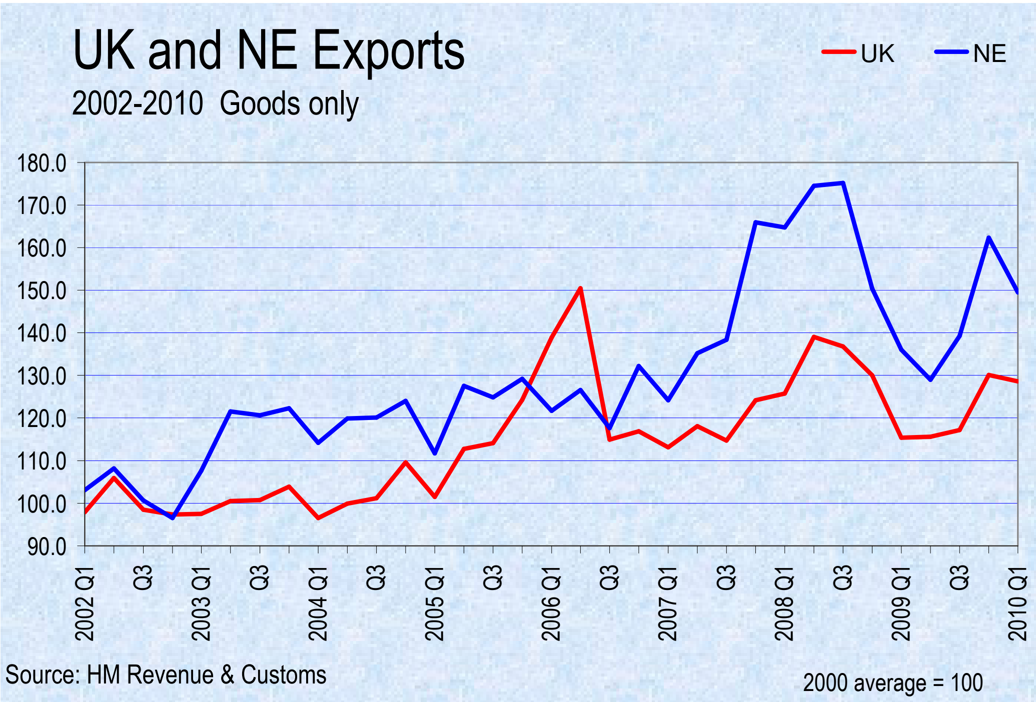


	Oct-Dec 2007	Jan-Mar 2008	Apr-Jun 2008	Jul-Sept 2008	Oct-Dec 2008	Jan-Mar 2009	Apr-Jun 2009	Jul-Sept 2009	Oct-Dec 2009	Jan-Mar 2010
Tyne and Wear	5,513	3,372	3,429	2,546	2,049	1,599	2,396	2,602	2,690	1,803
North East	14,225	8,606	9,048	6,563	5,415	3,899	5,801	6,344	6,721	4,637

Source: Land Registry Address file (compiled by TWRI). Caution: data are not seasonally adjusted.

3. Exports Note: exports may be critical to NE economic recovery in the medium-term (say 2011-15).

NE[5] goods exports (by value) dipped 8% in Q1 (graph below); to £2.54bn. Exports to all regions fell except the EU (up 2.6%, to £1,526m). Exports to N. America dropped by 35%. Exports to other global regions generally fell by around 10%.



4 Sales were down about two-thirds over the 2 years to late 2009.
5 HMRC Tyne & Wear data are not available to TWRI.

Machinery & Transport goods, TW's key exports (and which includes vehicles) dropped 12% to £1,220m (after a 41% spurt in Q4). NE exports of Machinery & Transport were about 5% lower than in mid-2008 and 11% lower than at peak.

4. Aggregate Job Gains and Losses in TW (Apr-June 2010) – reported in the press:

There was a *reported* net job loss for TW again of about -400*. This follows gains of about 1,300 in each of the last two quarters of 2009. This is the first deterioration since Q1 2009.

Summary of job gains and losses (announced in the press).

Apr. 1st - June 30th 2010, for Tyne & Wear

District	Gain	Loss	Net
Gateshead	260	0	260
Newcastle	280	392	-112
North Tyneside	325	44	281
South Tyneside	10	407	-397
Sunderland	77	513	-436
Unallocated #	0	40	-40
Tyne and Wear	952	1,396	-444

Unallocated gains and losses are usually estimates at County level of regional change.

Source: compiled by TWRI from the Journal and other local media.

Caution: press reports are very incomplete. In particular, they essentially omit construction job change, small job losses in retailers and other service firms. Historically they have omitted major growth in public service employment in health and education. Nevertheless, the reported job changes give a strong sense of overall employment change.

Claimant unemployment has been falling since autumn 2009. By June 2010 it was down by nearly 3,000 over the last 12 months. Previously it had risen by about 15,000 in TW in the year to June 2009 and stabilised in the second half of 2009 at around 38,000.
More details, including an itemised list of gains and losses, will be presented in the TWRI State of the Tyne & Wear Labour Market Report for Summer 2010.

5. Structural Change in the TW economy:

- The biggest job gains were not structural changes but recoveries by two firms. Nissan taking on 400 in temporary jobs, in response to rising orders for the *Qashqai*. 24-hour working has been re-introduced. Longbenton Foods (formerly Findus) was taking on another 150.

Structural Changes bringing Gains:

- Motor insurer, **Insurethebox**, is creating a new call centre at Quorum Business Park. It is to employ 150 people. [It is not clear whether this is to be in the new Q12 Building which is due for completion in November.]
- A **Crowne Plaza Hotel** near the Central Station in Newcastle (and a boutique hotel) are expected to employ over 100 [perhaps by late 2011]. InterContinental Hotels is the operator.
- Structural Changes bringing Losses:
- **Northern Rock** is retrenching with 650 job losses, as it prepares for its sale and return to the private sector.
- **Garlands** closed its (new) call centre (-178) in South Tyneside, as the company went into administration.

UK ECONOMY

6. UK Economic Context:

The UK economic recovery has strengthened. In Q2 (Apr-June) growth accelerated sharply (prelim. est. to 1.1%[6] in the quarter-ONS 29/7). Manufacturing and services both jumped at or close to 1.0%. Manufacturing output is up over 4% from a year ago and UK car sales are up over 10%. This is the third successive quarter of growth.
At last, **employment grew strongly, est at 160,000 (0.6%) in** the **3 mths to May.** Growth was, however, in part-time employment (est. at 148,000). This suggests a high degree of hesitancy by employers about the strength of the recovery.

Households remain under great pressure, with real earnings falling by several percentage points over the last year. In the year to June, **real earnings fell by over 3%** (earnings excl bonuses grew by 1.8%[7] and RPI prices rose 5%).
Thus **household consumer spending in real terms**[8] has **fallen only 0.5% in the year to** the **first quarter**[9] of 2010. Consumer spending growth in Q1 from Q4 rounds to 0.0%.

Bank Lending remains **very weak;** UK **businesses continued** to **pay back to the banks in May** – BoE Trends in Lending July 2010. Outstanding mortgage lending is still growing at under 1%pa. House prices continued to weaken a bit over the last 3 months [Note: this could be the start of further weakness, and needs to be closely watched].

7. Prospects:

Future UK economic prospects are for growth to accelerate in 2011 (although to below the normal rate) and for unemployment to almost stop rising in 2011 (table, below). Note: the independent forecasts still appear to imply a rise in claimant unemployment in 2010.

	2010	2011	Comments
Economic Growth	1.2%	2.1%	Upturn still weak but much less so than June forecast (0.6%).
Claimant Unemployment	1.60m (Q4)	1.64m (Q4)	Unemployment to rise 140,000 in 2010[10], then be almost stable in 2011 (up only 40,000).
Govt Borrowing (PSNB)	£149.8bn (2010/11)	£124.0bn (2011/12)	Govt. borrowing to fall by about £25bn (about 1½ % of GDP) in year beginning April 2011.
CPI inflation (Q4 in each year)	2.6% and RPI inflation to be 3.9%	2.2% and RPI inflation to be 3.4%	Inflation to return within 1pp of CPI target by end-year. RPI inflation to slow by over 1pp before end-year.

Source: average latest revised UK forecasts, from HM Treasury's survey of independent forecasts (published by the Treasury in July 2010).

Note: the above independent view of prospects is close to those set out by the Treasury. The main risk over the next 3 years (to mid-2013) is downside, that growth could be slower. In particular this could come from an economic shock from the Eurozone.

[6] Caution: these ONS preliminary estimates are always based on very incomplete data, and TWRI suspects may well be an over-estimate. The CBI and National Institute both forecast in July the figure to be around 0.7%. Surveys (esp. the PMI) noted a slowing in June.
[7] Mar-May 2010 compared with same period in 2009, 'regular pay' from the UK Lab Mkt Statistics Bulletin, July 2010. Total pay (inc. bonuses) rose 2.7%.
[8] Known in the National Accounts by the Treasury code ABJR, in Economic & Labour Mkt Trends July 2010.
[9] Q2 data on consumer spending are not yet available from ONS website.
[10] TWRI calculation on the assumption that forecasters use UK seasonally adjusted unemployment. This was about 1.146m in June 2010.

The UK Budget set the "Treasury trajectory" for the UK economy over the next five years. To attain overall employment growth, whilst cutting the public sector, requires significant private sector growth. To achieve this, interest rates may have to kept low for an extended period. The Chancellor needs a "Plan B" in case economic growth is significantly weaker than forecast and needed.

Tyne & Wear's economic prospects are determined largely by the UK trajectory.

Crucially, consumer spending (2/3 of total demand in the economy) is expected to grow more slowly than the economy (in 2011 1.3% OBR)[11]. This is the opposite of the position for the decade to 2007. Govt. spending, too, is no longer growing faster than the economy

This leaves exports and investment as the two components of demand which can potentially grow faster than the economy.

The **next five years** could see private sector growth, with unemployment peaking only about 0.2m above the current level (CBI, OECD etc.).
The budget cuts means that public employment is set to fall by about half a million nationally (OBR ests.). In Tyne & Wear, therefore, we can expect public sector direct job losses of the order of 15,000. This equates to about 3% of all employment in Tyne & Wear, but the losses are to be gradual over five years.

Local factors also apply;
TW has a higher proportion of jobs in the public sector than the UK; a simple pro rata of 0.5m losses across the UK is less than 2% of jobs in the UK but around 3% in TW.

On the positive side, TW does not have a large financial sector (as e.g. Leeds and Edinburgh do); this remains likely to be a slow growth sector for some years yet.
Secondly, the NE and TW are export regions. Exports of goods are a higher proportion of total output than for average UK regions. This is an advantage provided export markets grow faster than the UK (or at least that TW exporters expand faster than UK markets).
(For more details on the prospects for exports, see the Autumn 2009 and Winter 2009/10 editions of this report).

8. Credit Crunch[12] – recent developments

- **Bank lending to businesses** has continued to be **negative** (this **means businesses, overall, repaid** loans to **the banks**)*. This has continued since early 2009. In 2007, growth of bank lending to business had been over 20%.
- Mortgage lending continues to grow at under 1%pa.
- Consumer credit continues to grow at under 1%pa.[13]
- **Liquidity** has **replaced capital** as **the main problem of the banks**. UK banks have to re-finance over £750bn of their borrowings by end-2012 – the BoE Financial Stability Report warned. They have been doing this re-financing at only about half the rate required. [Banks are, therefore, shrinking their balance sheets (i.e. cutting lending) to meet this target.]

* This information comes from a survey of the six big UK lenders. The Bank of England proposed to cut the frequency of its monthly report 'Trends in Lending' (TIL) to quarterly. TIL has two major weaknesses; i) it only presents data from the banks, not from customers (and potential customers) ii) it excludes the lending of foreign banks to UK businesses, which is understood to have fallen very significantly.
Information on the impact of bank behaviour on *NE* business remains meagre. The survey by BENE gives some indications. (The next one is expected in September.)

[11] From HM Treasury Independent Forecasts, July 2010 (p7). Av. of independent forecast made in the last 3 months is 1.4%.
[12] Credit Crunch means the restriction of credit by lenders, by quantity and prices. This section covers the health of the banking system.
[13] Source: The Bank of England's monthly 'Trends in Lending' report (July). This is largely based upon a survey of the Big Six lenders; caution: it omits foreign lenders.

Eurozone Govt Debt Crisis

The banking crisis developed a major EU dimension from May, triggered by the Greek govt's inability in April to fund its borrowings at reasonable rates. A special €750bn EU-IMF fund was set up at the start of May to enable weaker states to finance their deficits. This fund runs until mid-2013.

In May and June southern European govts were unable to borrow in the bond markets. In July some of this has resumed.

This "Eurozone sovereign debt crisis" runs the risk that a member govt may default on its debts (probably by at least rescheduling). This would create losses for the banks. The debt of the Greek govt is of the order of €300bn.
Major EU banks were subjected to "stress tests" in July for the period to end-2011. The tests were, however, weak; they assumed no EU govt defaults. They also only measured capital, not liquidity.

This 'Eurozone crisis' at least makes exporting for UK firms less profitable and more difficult. It has created a risk that banks across the EU will suffer very significant losses (a 'second banking crisis', after the one in 2008). The crucial country in terms of whether this crisis is manageable (in scale) may well be Spain.

Quantitative Easing (QE)

The Bank of England's MPC QE programme remains suspended, after it created £200bn (of new money) in the year from March 2009.
If the economy were to be heading into a second recession ("a double dip"), QE could be resumed (FT 24/7).