QUARTERLY

STATE OF THE TYNE & WEAR ECONOMY REPORT
Winter 2009/10

Job changes covering Oct to Dec 2009
Local News to Feb 4th
Bank Lending Latest BoE Report Feb 18th.

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TWRI
1st Floor Provincial House
Northumberland Street
Newcastle upon Tyne
NE1 7DQ
Tel: (0191) 277 1912
Fax: (0191) 277 1911
E-MAIL: twri@twri.org.uk
WEBSITE: www.twri.org.uk

Supported jointly by Cities of Newcastle and Sunderland and the Metropolitan Boroughs of Gateshead, North Tyneside and South Tyneside

KEY POINTS

UK Economic Overview

For the first time since its peak in Q1 2008, the **UK economy grew in Q4, but slowly.** ONS' initial estimate (27/1) of GDP growth is only 0.1%; Note: for Q3, ONS later revised upwards its estimate of GDP by 0.2 percentage points. This marks the end of recession, in the sense of falling output. UK output remains 6% below its peak, and about 10% below its pre-recession trajectory.

UK economic **growth in 2010** is **forecast to be 1.4%** –Independent forecasts (compilation by HM Treasury of Dec 2009 forecasts). The CBI forecasts a little lower at 1.2% in 2010. [If UK economic growth is 1.2% in 2010, it can be expected to be under 0.3% in Q1 because some of the fiscal stimulus has been removed, particularly the VAT rate cut, but also the stamp duty holiday for lower priced houses. –Ed]

One of the **top three risks** to the UK economy is a govt. **budgetary crisis** this year - rated by almost half (47%) of economists. The risk is such a crisis stops economic growth until at least the end of 2010 – FT survey of 79 economists (FT 04/01) See the Nov/Dec edition of this TWRI report for a feature 'Why the UK Govt. needs to cut the Budget Deficit; avoiding the Public 'Debt Trap'. [In January, Greece cut its govt. budget by a tenth, as it tries to limit its public debt. –Ed.]

Annual inflation surged in December (even before the VAT rise), with CPI at 2.9%, due to the unusual monthly fall of 0.4% in Dec08. When it rises above 3% the Governor will have to publish a letter to the Chancellor, which "looks certain" when new inflation figures come out on Feb. 16th – according to the Economist (EcN 23/1).

Unemployment

UK unemployment has been falling in **the autumn** months**: Claimant unemployment *fell* in Dec.** even on the seasonally adjusted series (-15,200); this is the 2nd consecutive fall in over 1½ years (since February 2008). The same variable had also fallen in Nov (- 6,300) to 1.630m.

Also ONS' estimate of **UK unemployment** (the **official definition from LFS**) **fell** by 7,000 to 2.458m in the 3 months to Nov. This is the **first fall** for about 1½ years. It follows very small rises, around 20,000 up to October, contrasting with rises of about ¼m estimated for 3-mth periods last winter. Caution: these LFS ests. can be volatile.

In **Tyne & Wear, claimant unemployment** has **fallen** a **cumulative 300 over the 3 months since Sept.**. It had broadly stabilised since April. It then fell -59 in October, a further -622 in November but rose +382 in December. In Dec., however, TW claimant unemployment was still about 7,500 (25%) higher than a year ago. Caution: the TW series is *not* seasonally adjusted.

TW's rise in claimant unemployment in **December** was **led by South Tyneside**, with a rise of **188** and **North Tyneside**, with a rise of 122. Both Newcastle (+61) and Gateshead (+72) has smaller rises. Claimant count fell in Sunderland, -61.
Caution: there is no seasonally adjusted (SA) series by ONS for the claimant unemployment count for Tyne & Wear. (ONS does produce, down to each region, an SA series for the claimant count. One NE uses this NE SA series.)

Claimant unemployment is forecast to rise modestly, by a further 0.12m by end-2010 (HM Treasury compilation of independent Dec. 2010 forecasts). (This suggests *pro rata* for Tyne & Wear's employment base, a rise of about 2,500).

Global Context

World trade volume growth was **strong in Q3** but has since slowed. In Aug., the value and volume of UK exports had risen for the first time in a year (FT 10/10). In Q3, however, UK export growth was slower than imports and the trade deficit thus widened.

NE's goods exports in Q3 grew 8% (after a small fall in Q2 just -3%). Exports **to N America** grew impressively, **up by over a quarter** from Q2. But NE exports were still down a fifth on a year before. **Export markets** in **the EU** are forecast to remain **sluggish** in terms of GDP growth. Raising NE and UK exports looks essential for a stronger recovery; which probably means much more focus on Asia.

Local Job Gains

The Listening Company at St. James' Gate in Newcastle, is **creating 250 jobs** at its call centre. It has opened a new floor at its Newcastle base as part of its commitment to create 1,000 jobs in Newcastle.

Local Job Losses

The largest reported Job Losses were from **Wellstream**, in Newcastle. It is to shed up to 200 jobs in Feb. after its profits halved from £77m to a predicted £34m this year. It has problems in domestic and foreign markets as a result of project delays and a shrinking order book.

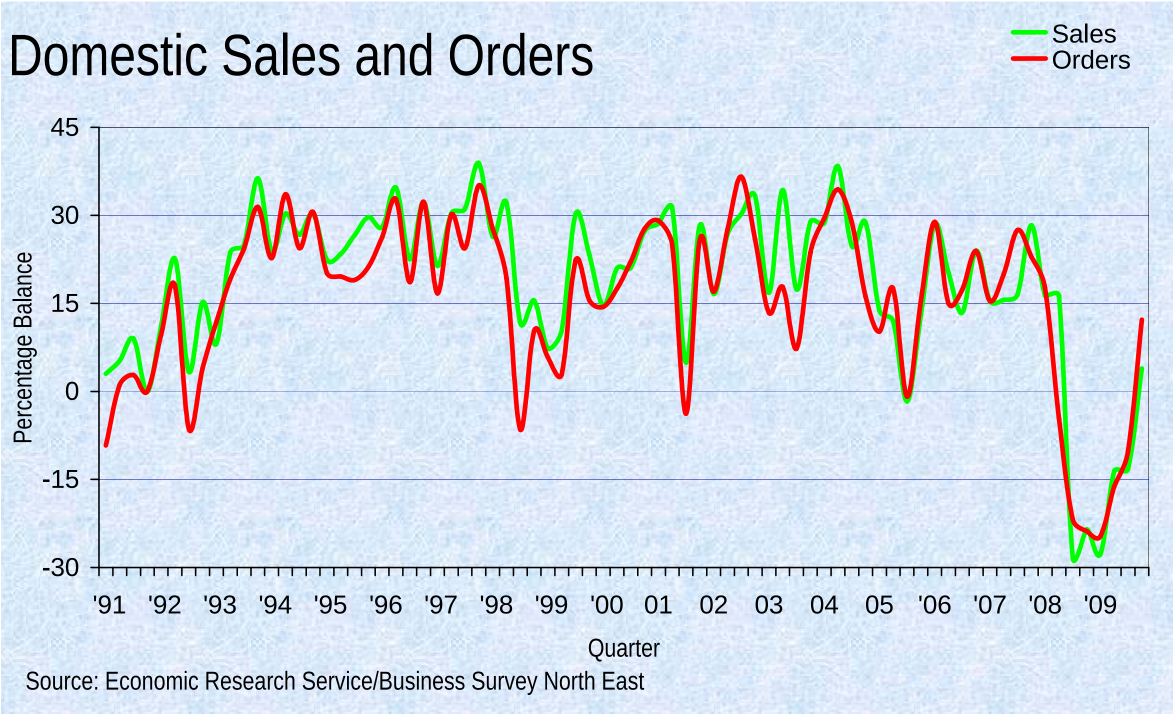
Note: Northern Rock bank has **been split** into two, prior to its sale.

Date: 4th Feb. 2010

TYNE & WEAR ECONOMY

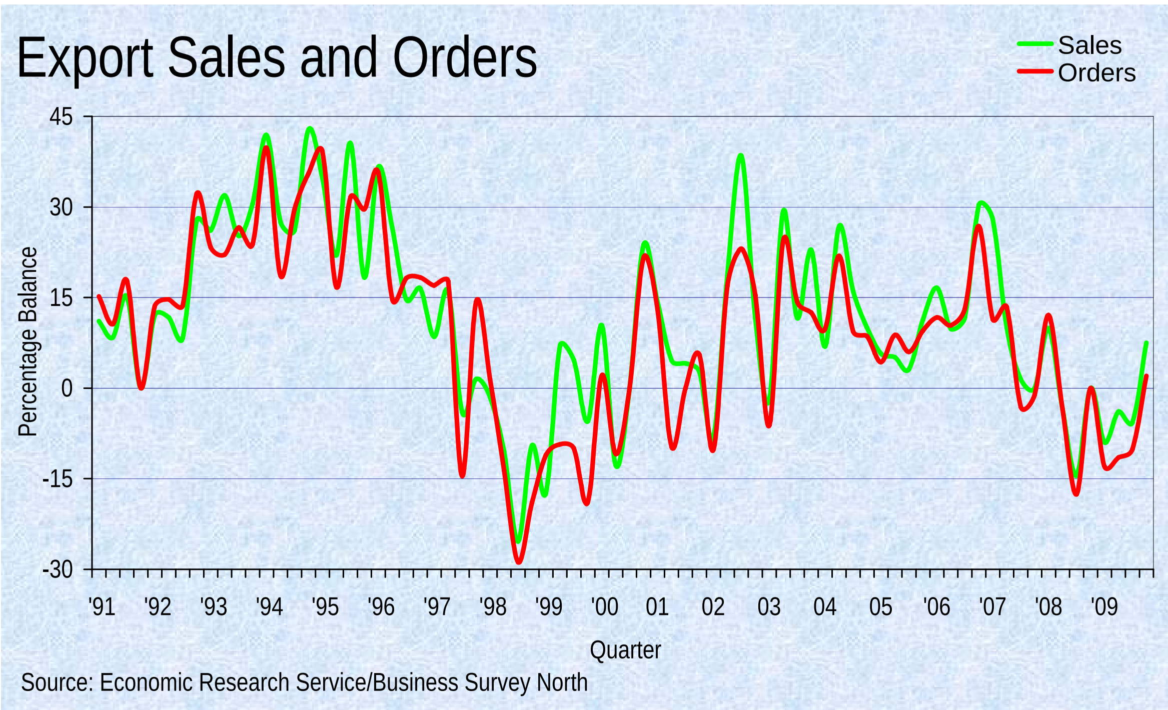
1. Indicators of Demand:

In the last quarter of 2009, TW firms reported domestic demand (UK customers) began to grow again, up very slightly (net balance under 4%). Growth of orders was stronger (balance of 12%). Demand from the UK had fallen most steeply in Q1 (a record fall of about -25% on the balance), easing in both Q2 and Q3, to around -13%.



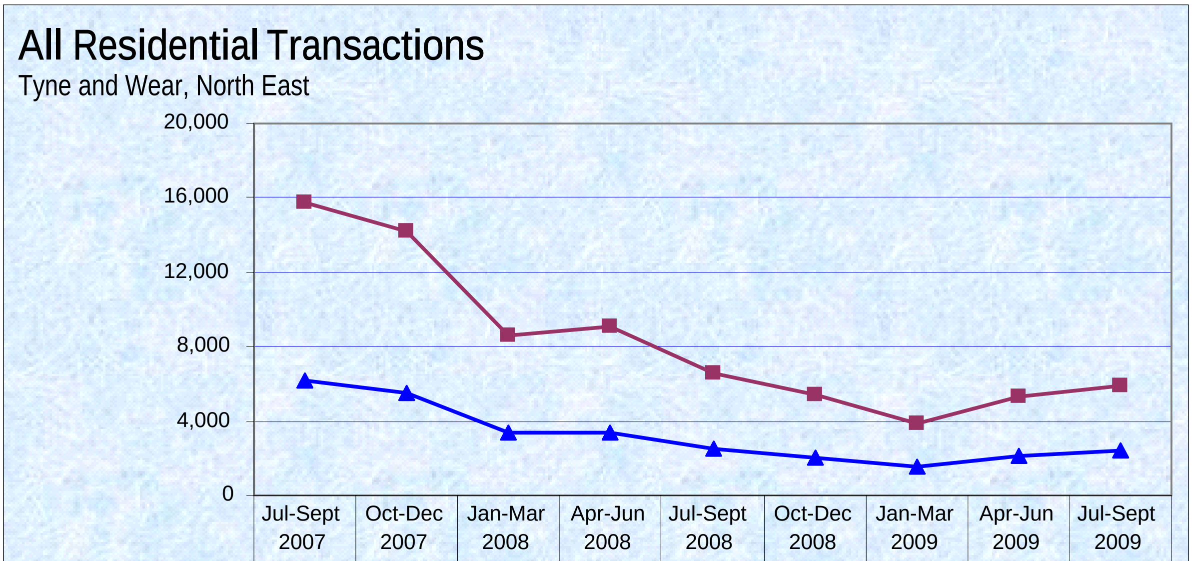
Note: these indicators of demand are from firms in Tyne & Wear (only).

Export demand also turned positive in Q4, but growth of orders (balance 8%) was weaker than sales.



2. Housing Market

In Q3 'summer' 2009, house sales ('All residential transactions', below) rose for the second successive quarter (TW up 12%). Nevertheless, in TW, house sales were about 6% (about 150) lower than a year, slightly less weak than the NE (down 10% or about 650). Compared with 2 years earlier (in 2007)(chart below) sales were still down by about two-thirds. Caution: sales are highly seasonal, in 2007 TW sales rose in the spring, falling 2% in the summer.

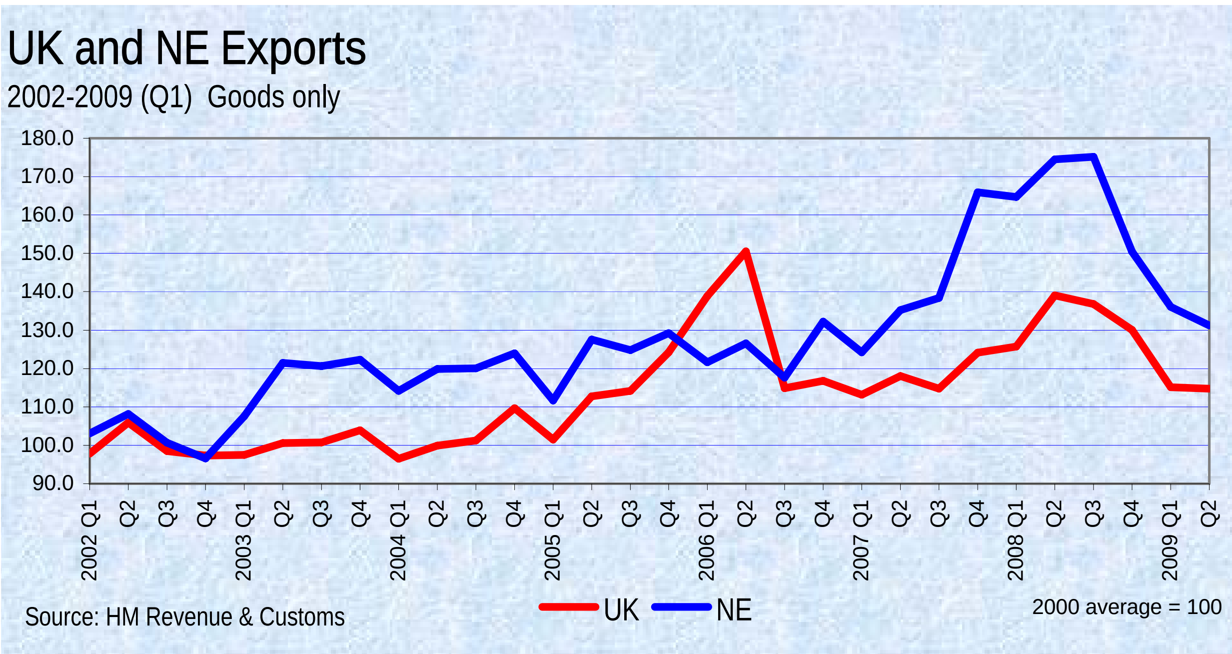


	Jul-Sept 2007	Oct-Dec 2007	Jan-Mar 2008	Apr-Jun 2008	Jul-Sept 2008	Oct-Dec 2008	Jan-Mar 2009	Apr-Jun 2009	Jul-Sept 2009
Tyne and Wear	6,185	5,513	3,372	3,429	2,546	2,022	1,568	2,143	2,395
North East	15,722	14,225	8,606	9,048	6,563	5,370	3,841	5,295	5,901

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

3. Exports Note: exports may be critical to economic recovery in the medium-term (say 1-5 years).

NE[1] goods exports (by value) grew 8% in Q3; to about £2.4bn. Strong growth was first to Asia (up a big 28% in Q2, to £267m). In Q3, NE exports to N. America grew by a quarter [helped by re-stocking in the USA]. Overall, NE exports are still down a fifth on a year ago. Exports to EU markets (57% of NE exports) have grown only 3% in Q3. Machinery & Transport, TW's key exports (which includes vehicles) continued to recover up12% on top of 22% in Q2; they are still down 29% from peak and 11% on a year.



[1] HMRC Tyne & Wear data are not available to TWRI.

The only global region yet to show renewed growth for NE exports in Q2 or Q3 is Eastern Europe (exc. EU)[presumably mainly Russia]; NE exports here had doubled in 2007 to £603m (equivalent to about 1% of NE GDP). In the first three quarters of 2009, however, exports to Eastern Europe have been down around three-quarters from 2007 levels (a loss of exports worth about £450m annually). E. European markets are known to be constrained by a severe withdrawal of banking credit. The Russian car market has roughly halved from peak. If these lost exports were all cars (clearly a worst case for TW), they could equate to around 40-50,000 cars or nearly a quarter of Nissan's overall decline in production.

NE exports grew to two of the small global regions; up 17% to the Middle East (to £75m) and up 53% to Sub-Saharan Africa (to £29m).

4. Aggregate Job Gains and Losses in TW (Oct-Dec 2009) – reported in the press:

There was a *reported* net job gain for TW again of about +1,300*, as in Jun-Sept; an acceleration from the net gain of +500 in Q2. The improvement has been sustained from a net loss of -1,100 in Q1.

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

Oct 1st - Dec 31st 2009, for Tyne & Wear

District	Gain	Loss	Net
Gateshead	400	93	307
Newcastle	572	457	115
North Tyneside	1194	492	702
South Tyneside	167	385	-218
Sunderland	580	72	508
Unallocated #	90	174	-84
Tyne and Wear	3003	1673	1330

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 rose by about 15,000 in TW in the year to June 2009 but 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.

5. Structural Change in the TW economy:

- The major £100m+ extension to Eldon Square Shopping Centre, in Newcastle city centre, opened on February 16th, including the new Debenhams store.
- Details have still to emerge about Nissan's plan to develop a new factory in Sunderland to make (lithium) batteries for its new range of electric cars.
- The former Findus factory was re-opened by Longbenton Foods.
- The former DFB dairy at Blaydon, Gateshead, has been acquired by Medina Dairies, a UK independent chain and is due to re-open with 50 employees (a quarter of its previous size).
- SLP has gone into administration; it was having a fabrication shop built to build large wind turbine components.
- There has been no news on major property developments which are planned in Newcastle; the £200m Downing Plaza and the £200m Stephenson Quarter. These are due to bring 1-3 new hotels and some office space.

UK ECONOMY

6. UK Economic Context:

Growth restarted in the UK economy in the Oct-Dec quarter of 2009. The rate of 0.1% growth was ONS' "initial estimate" (which is often later revised upward). Previous initial estimates have been revised upward (e.g. by 0.2pp for Q3). **If** the **UK can achieve 0.3% growth each quarter** in 2010 (on average) it will be **broadly consistent** with **both independent (Dec) and Treasury (PBR) forecasts**. Such a growth rate (1.2%pa) would be about half or less than the UK's long-term average. Economic growth is being constrained by three factors;

a) Govt stimulus being smaller than in 2009,

b) bank lending growth being too slow,

c) the level of employment is falling (slightly), the fall could well accelerate somewhat in the first half of 2010 and if employment growth occurs it will be weak,

d) thus consumer spending growth will be weak (say 1-2%, after 3% in 2009) or even flat (as it was in the 1991, the last year the UK had a big recession).

Consumer spending, and consumer confidence is, as always, crucial to the overall growth rate – because it is around two-thirds of total demand in the economy – but this year is set to be unusually weak. Consumer spending was kept growing in 2009 by one-of measures; through both big mortgage rate cuts (which boosted incomes in real terms), and by the temporary VAT cut. Thus from December 2009, earnings growth began to be outpaced by inflation – meaning living standards have begun to fall (perhaps by 1 or 2%). This **squeeze on living standards** will continue for as long as inflation exceeds earnings growth (which currently means if inflation is above about 1%); the Bank of England expects inflation to exceed the 2% target for several months in early 2010. Moreover, **households cannot significantly boost their spending through borrowing**; the banks only expanded net lending on mortgages by about £15bn in 2009; it had been about six times this in 2007. This (2009) growth of mortgage debt (the same thing as growth of net mortgage lending) is very roughly the equivalent of only about 1% of household income annually. In 2010, finally, the credit crunch is set to impact on consumer spending. One clear unknown is the rate of change in the employment level; the UK fall of under 0,000 (in 3 months) in the autumn is negligible (about -0.1%pa). This fall in the number of people in employment, however, seems to be accelerating in the early months of 2010 (the CIPD survey reports planned job cuts are over 1½ times as common as in Q4) but the scale is unclear.

Bank lending growth is **too weak** to **ensure satisfactory economic growth**. There is well-informed concern amongst economists (outside the Bank of England's 'Trends in Lending' report, at least). Independent economist Roger Bootle, who forecast the credit crunch, has stated (8th Feb., R4) that the government cannot simply allow the banks to reduce their balance sheets (as they are doing). The banks have losses est. at £50bn on their loans on commercial property (FoF, R4). He said, to ensure sufficient lending, the **Govt will have to** do at least one of a) **recapitalise the banks** (a third time) **and/or** b) tell/**order the banks to lend**.

The last Section of this report (on the Credit Crunch) sets out the evidence of weak lending, from the Bank of England itself. It is weak by the Big Six lenders, and lending by foreign banks is shrinking more rapidly. The "credit crunch" is the contraction (or constriction) of bank lending. This makes achieving positive economic growth very difficult (because it cuts demand in the economy).

The major route out of recession for the UK is **export-led growth (plus business investment); in this** in this the NE is well–placed still with a larger manufacturing base than most UK regions, bigger firm size and much higher export-orientation. In this restructuring of the national economy, the UK now needs significantly bigger exports. The UK's 2008 goods exports of nearly £250bn (one fifth of the UK economy) need to grow as quickly as possible by £30bn or so to close the trade gap. If the NE is to deliver 5% of this putative target, it would add £1.5bn or 13% to NE goods exports (from 2008) to reach about £12.8bn. In 2009 they dipped to roughly £10bn. This gives a measure of the challenge; to **grow NE exports from their depressed 2009 base of around £10bn by a quarter or more** as soon as possible. Given that NE exports to the EU were still 57% of the NE total (in Q3), the growth of demand in EU markets still remains crucial to NE export opportunities. The opportunities for big rapid growth of NE exports now mainly lie outside the EU, notably broadly in Asia, North America and the Middle East. These are the global regions with economies with significantly faster long-term economic growth than in the UK and the EU. The NE needs to get much better connected to them, and develop deep long-lasting large-scale trading relationships.

7. Prospects:

Future UK Economic Prospects are for slow growth in 2010. Tyne & Wear's economic prospects (for at least the next year or so) are determined largely by the UK trajectory.
Local factors also apply; One big one is that NE (and especially TW) exports tend to be investment-type goods (vehicles and machinery) and demand for these are more sensitive to the rate of growth of real incomes than are average exports; TW exports fall steeply when export markets are in recession, but have the prospect of a strong rebound.

	2009	2010	Comments
Economic Growth	-4.7%	+1.4%	Upturn still weak but much less so than June forecast (0.6%).
Claimant Unemployment	1.64m (Q4)	1.76m by Q4 2010	The forecast rise in unemployment in 2010 has been moderated by almost half since Sept. to a further 120,000 in 2010, instead of about 200,000.
CPI inflation (Q4 in each year)	1.9% and RPI inflation to be 0.1%,	1.9% and RPI inflation to 3.0%	The acceleration in inflation in early 2010 is temporary, returning to target by end-year. RPI inflation is faster presumably as mortgage costs rise in 2010.

Source: average latest revised UK forecasts from HM Treasury's survey of independent forecasts (Jan. 2010).

As stated in the previous edition of this report (in October), three global regions appear critical to Tyne & Wear's sustained economic growth:
"TW's ability to achieve a higher [economic growth] trajectory than the UK will, to an important degree, depend on its ability to raise exports,

- especially to fast-growing developing country markets (notably in Asia).
- Faster economic growth in the Euro-zone than in the UK would also be helpful to TW's economy (relative to the UK), because TW is (probably) more oriented to exports than is the UK, and this is the dominant export market.
- A recovery in demand from other markets, notably eastern Europe (excluding the EU), mainly Russia, would also be helpful. "

Now, in February, we can add that the Govt needs to ensure that bank lending grows more rapidly, so as to support economic activity across the UK – and particularly to ensure small and medium-sized firms can grow to meet demand when it grows.

8. Credit Crunch – recent developments

- **Bank lending to businesses** has continued to be **negative** every quarter in 2009 (**this means businesses, overall, repaid loans to the banks**)*.
- Moreover, the decline each quarter has risen from -£0.6bn in Q1, -£5.2bn in Q2, -£6.9bn in Q3 and -£8.8bn in Q4.
- Importantly, this weak **lending to business *could well be*** *the* ***major explanatory factor*** for **the UK's weak economic growth**, particularly in Q3 and Q4.
- Growth of bank lending to business was over 20% in 2007, slowed to over 10% in 2008, but has fallen progressively throughout 2009. By December, the **12-month 'growth' rate was -8.1%.**

Source: The Bank of England's monthly now called 'Trends in Lending'. This is largely based upon a survey of the Big Six lenders; caution: it omits foreign lenders.

The February report states;

- The flow of **net lending[2]** to **companies** was **negative** every month from April to December (except Nov.) with -£4.3bn in December.
- [Lending for commercial property is being protected by the banks.] 'Nonetheless the stock of **real estate lending** – which accounts for **nearly 50% of the total stock of business loans** – was **broadly unchanged in 2009 Q4 on a year earlier**, in contrast to the decline in the stock of loans to the ret of the corporate sector over that period.' [This implies that the rate of decline of the stock of **lending to *businesses other than real estate* has fallen twice as rapidly (around -16%)** as overall (-8%) over the 12 months to December.]
- 'In contrast to the picture for businesses overall, **gross repayments** of borrowing **by small and medium-sized enterprises rose gradually during 2009**, according to data collected by the Dept. for Business, Innovation and Skills'.

Quantitative Easing (QE)

The Bank of England's MPC decided to suspend its QE programme once its planned £200bn (of creation of new money) is reached.

[2] Official data covering lending by all banks and building societies.