QUARTERLY

STATE OF THE TYNE & WEAR ECONOMY REPORT Autumn 2010

Job changes covering July to Sept 2010
Local News to Sept
Bank Lending Latest BoE Report Sept

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KEY POINTS

This report covers the 3 months to end-Sept.

UK Economic Overview

UK economic growth was maintained at a strong rate in **Q3 (July-Sept),** at 0.8%, above its normal 0.6 or 0.7% rate (ONS' provisional est.). This follows the strong 1.2% growth in Q2.

The **Comprehensive Spending Review** (CSR), plus knock-on losses from the private sector, **could cost Tyne & Wear about 20,000 jobs** (about 4% of all jobs) – based on a PwC report which estimates 43,000 job losses in the NE. CSR set out how departmental spending will be cut by 19% in real terms from previous plans. In real terms spending will be about 3% lower in 2014/15 than in 2010/11. The Chancellor still needs a "Plan B" in case economic growth is significantly weaker than forecast and needed.

UK growth is surprisingly fast 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.**

Local Economy

Local business indicators (for TW) show **a severe weakening in Q3** in **UK demand**. But export demand has strengthened. Oddly, UK demand is down like in 2009. They do not corroborate the strong UK GDP growth, possibly because the economy was slowing and the survey was in September.

Unemployment

ONS' estimate of **UK unemployment** (the **official definition from LFS**) *fell* (for the second successive 3 months), down 34,000 to 2.45m in the 3 months to August. Thus the rate has fallen 0.1pp from the previous 3 months to 7.7%. Caution: these LFS ests. can be volatile.

UK claimant unemployment has been **almost flat in the last 3 months** (up about 10,000). It had fallen since the autumn (except around January)**: Claimant unemployment *rose* 5,000 in Sept** on the seasonally adjusted series. The same variable has also now fallen by 160,000 since Nov (1.630m) to 1.47m. This suggested a slowing of economic growth.

In **Tyne & Wear, claimant unemployment** has risen by 250 from June to September. It was, however, still **lower from a year earlier by over 2,800** at 35,021. Caution: TW series is *not* seasonally adjusted.

TW's fall in claimant unemployment in the year to Sept was **led (newly) by Gateshead -696 (-11.2%) but also Sunderland**, with a **fall of 1,039 (-10.0%).** All other Districts fell by between about 3-7%. The weakest falls have again been in Newcastle (-5.4%, -493) and South Tyneside (-2.9%, -179). North Tyneside was close to the TW fall; (-7.0%, -420). Caution: there is no seasonally adjusted (SA) series by ONS for TW claimant unemployment count.

Global Context

Globally growth has accelerated a bit –IMF WEO. **The Eurozone** crisis[1] has remained stable after the €750bn EU/IMF support package in May.
The US economy has slowed and the Fed has been hinting since Sept that it will restart QE[2] to try to support growth.
Some developing countries are growing over-rapidly. Western policies are creating some of this over-heating.

The NE's goods exports in Q2 **jumped 17% on the previous quarter (up £425m[3]).** Export growth has oscillated (from Q3 8%, Q4 17%, Q1 -8%). In Q2, exports to N. America jumped by 38%, after a 35% fall. NE goods exports have recovered to their level of 2008, and exports of machinery and transport goods (TW's speciality) are 8% higher.

Local Job Gains

The largest gains were:
Balfour Beatty (200), in North Tyneside (at a new Customer Support Centre at Quorum Business Park).
2 Touch (80), the call centre operator in Sunderland.

Local Job Losses

The main job losses were at;
NHS North of Tyne [hospitals], (-166 by 2014) expected to be from Newcastle's RVI and Freeman Hospitals, and North Tyneside General.
Northumbria University (about -100) in Newcastle.

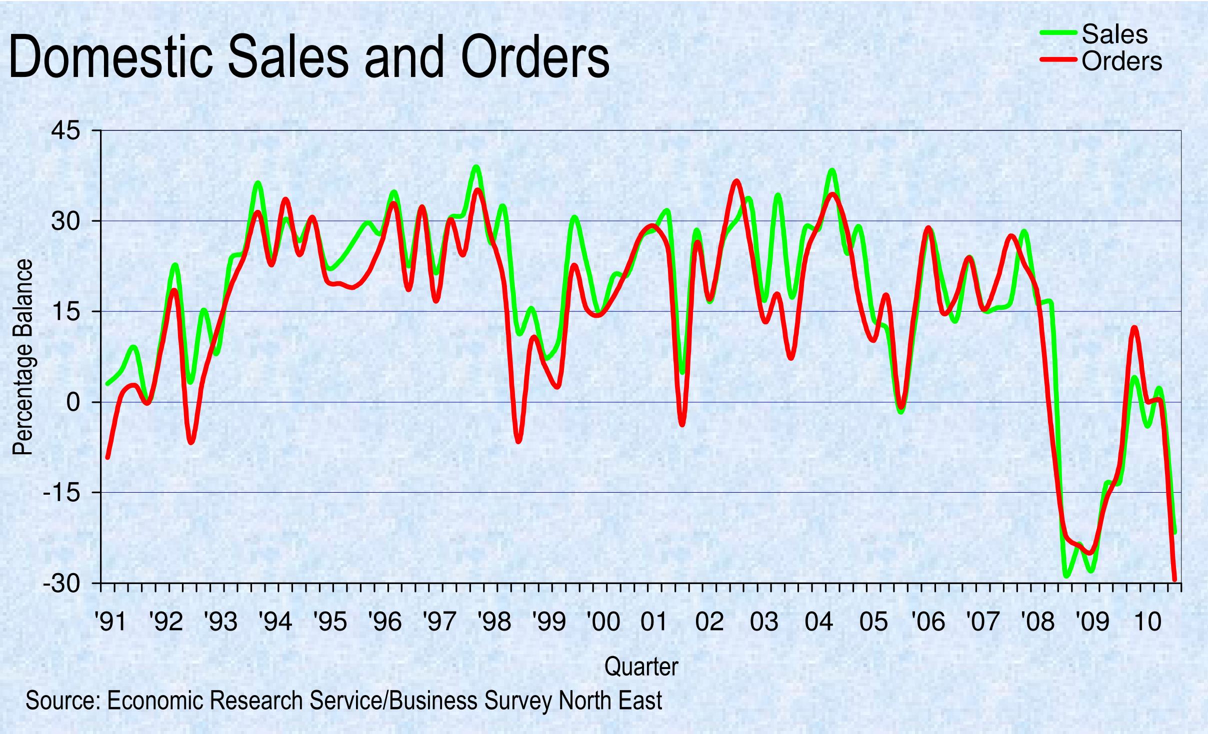
Date: 2nd November 2010.

[1] Shorthand for the crisis of govt debt and the banking system in the countries which use the Euro.
[2] QE is Quantitative Easing.
[3] This jump is worth about 3% of the NE's GDP (quarterly).

TYNE & WEAR ECONOMY

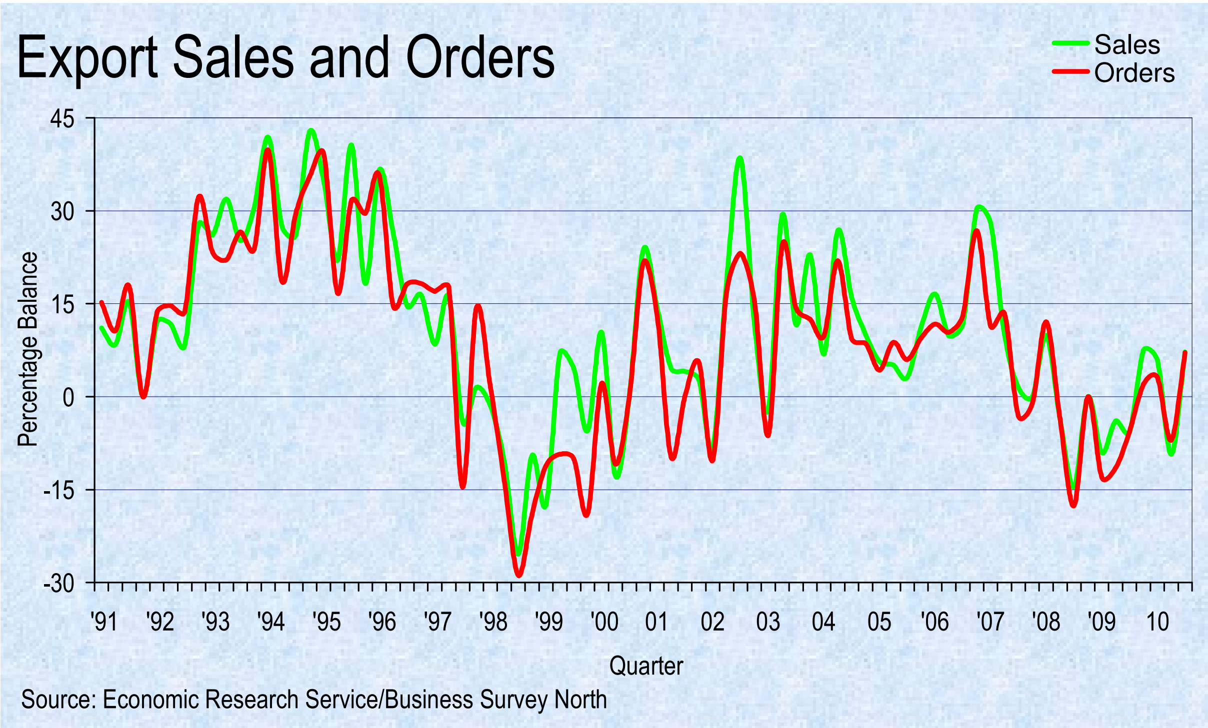
1. Indicators of Demand (in TW):

In the third quarter of 2010, TW firms reported domestic demand (UK customers) dropped sharply, with sales down almost like in 2009 (net balance -22%). Orders fell even more (net balance -29%).



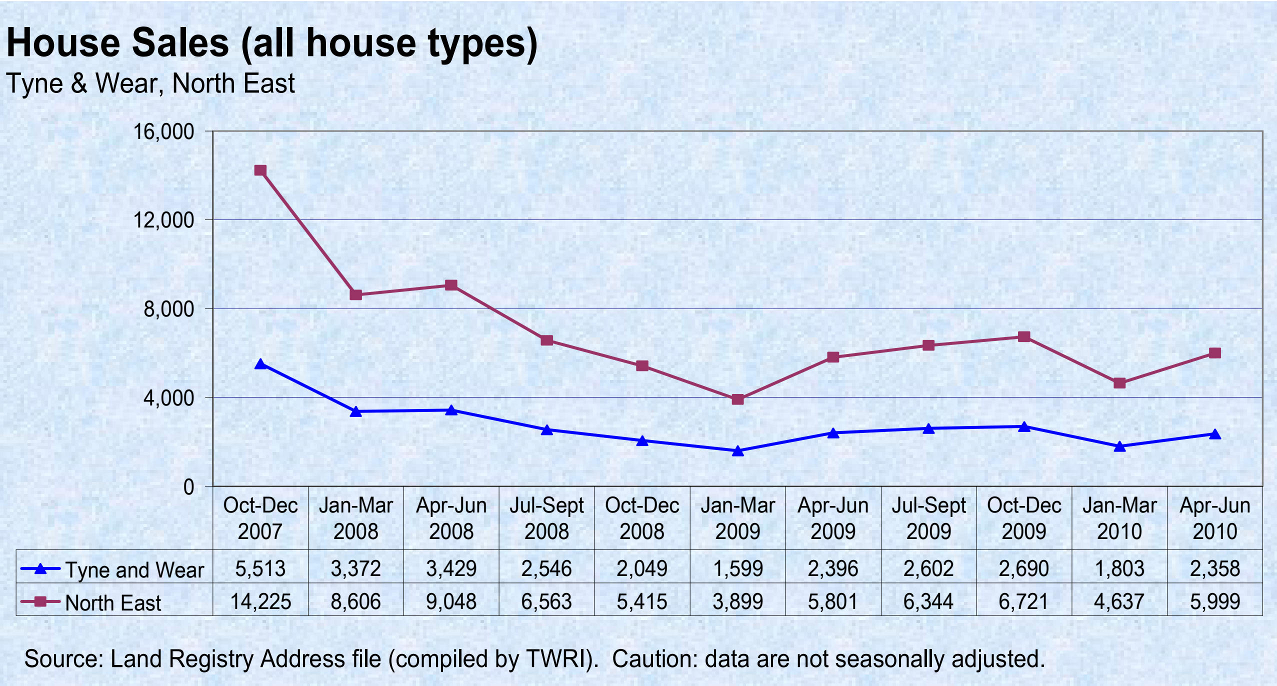
Note: these indicators of demand are from firms in Tyne & Wear (only).

Export demand rose in Q3, with sales and orders both on a balance of about +7%.



2. Housing Market

In Q2 'spring' 2010, house sales were little changed from a year earlier (TW down 2%, and NE up 3%)(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.

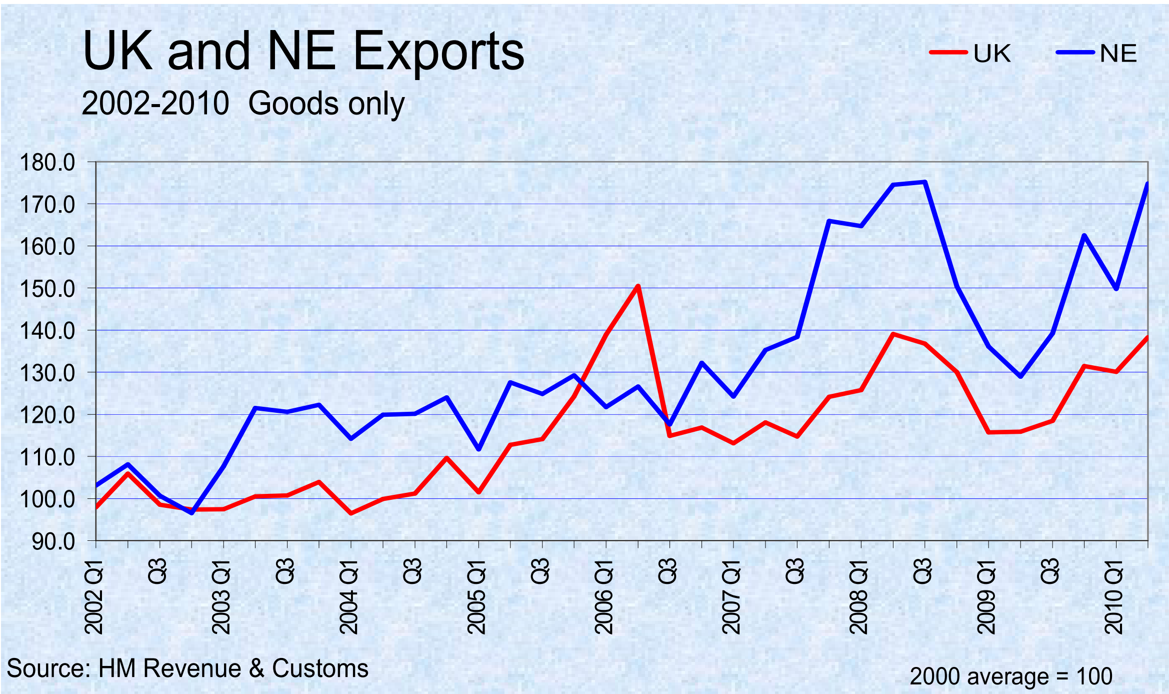


	Oct-Dec 2007	Jan-Mar 2008	Apr-Jun 2008	Jul-Sept 2008	Oct-Dec 2008	Jan-Mar 2009	Apr-Jun 2009	Jul-Sept 2009	Oct-Dec 2009	Jan-Mar 2010	Apr-Jun 2010
Tyne and Wear	5,513	3,372	3,429	2,546	2,049	1,599	2,396	2,602	2,690	1,803	2,358
North East	14,225	8,606	9,048	6,563	5,415	3,899	5,801	6,344	6,721	4,637	5,999

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) jumped 17% in Q2 after a drop in Q1 (graph below); to £2.97bn. Exports to the EU grew 6% (to £1,623m). Exports to N. America rebounded by 38%, after a 35% drop in Q1. Exports to (non-EU) Eastern Europe and Western Europe both jumped by over 50%. Nissan reported sales in Russia in September were up 108% from a year ago.



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[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) jumped 22% to £1,486m (after a 12% drop in Q1). NE exports of Machinery & Transport have now exceeded the 2008Q1 peak, by about 8%. Total NE goods exports have matched the level of mid-2008.

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

There was a *reported* net job gain for TW of about 150. This follows gains of about 1,300 in each of the last two quarters of 2009, and then losses of around 400 in each of the first two quarters of 2010.

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

July 1st – Sept 30th 2010, for Tyne & Wear

District	Gain	Loss	Net
Gateshead	70	50	20
Newcastle	348	580	-232
North Tyneside	30	50	-20
South Tyneside	108	37	71
Sunderland	326	85	241
Unallocated #	60	0	60
Tyne and Wear	942	802	140

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 sense of overall employment change.

By September 2010 claimant unemployment was down by nearly 3,000 over the last 12 months, much the same as the fall in the year to June. Claimant unemployment had been falling since autumn 2009. 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:

There was relatively little structural change reported in the quarter (July-Sept.).

Structural Changes bringing Gains:

- Balfour Beatty (+200) at Quorum Business Park, North Tyneside; As BB acquired Parsons Brinckerhoff in autumn 2009, it is possible these are jobs in consulting engineering.
- 2 Touch (+80), call centre provider at Doxford Business Park, Sunderland.

Structural Changes bringing Losses:

- NHS North of Tyne [hospitals], 166 Job losses (by 2014) in Newcastle and North Tyneside hospitals. The affected hospitals are expected to include the RVI, Freeman and North Tyneside General (based on a confidential document, 451 beds will be reduced, a 14% cut.)
- BEL Valves (-100[6]), from the maker of high-pressure valves, in Newcastle.
- Northumbria University (about -100), in Newcastle.

Late news: Liberty Electric Cars in Cramlington announced plans to create 500 jobs, after it won a huge order from China, which it said was worth £500m. It is to make electric motors for buses.

Also Tesco Bank opened its insurance operation in North Tyneside, initially employing 500 people.

[6] Apparently in 2009, but just reported.

UK ECONOMY

6. UK Economic Context:

The UK economic recovery has been maintained in Q3. In Q3 (July-Oct) growth at 0.8% was strong (after 1.2%[7] in Q2). Manufacturing grew by 1.0% after growth of 1.6% the previous quarter. This is the fourth successive quarter of growth.
Employment grew strongly, for the second successive quarter, **by 178,000 in the 3 months to August,** after **160,000 (0.6%) in** the **3 mths to May.** About three-quarters of growth was, however, in part-time employment (est. at 143,000 after 148,000 in the previous 3 months). This suggests a continuing high degree of hesitancy by employers about the strength of the recovery.

Consumer spending[8] began to grow in Q2, up 0.7%. This follows a big fall of 3% in 2009 from 2008[9]. **Households remain under great pressure**, with **real earnings down about 3%** (earnings excl bonuses grew by 1.7% and RPI prices rose 4.6% in the year to September). Household consumer spending in real terms had fallen only 0.5% in the year to the first quarter[10] of 2010. This was achieved by households cutting their saving rate. Employment growth is now also helping.

Bank Lending remains **weak;** UK **businesses borrowed a net £2.5bn in August** – BoE Trends in Lending Sept 2010. Outstanding mortgage lending is still growing at under 1%pa. House prices continued to weaken over the summer [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 continue in 2011 (although at below the normal rate) and for unemployment to rise by under 100,000 in 2011 (table, below). Note: the forecasters do *not* expect unemployment to rise substantially.

	2010	2011	Comments
Economic Growth	1.6%	1.7%	Economic growth forecasts have strengthened since July by about 0.5pp, but 2011 has weakened (by 0.4pp).
Claimant Unemployment	1.5m (Q4)	1.59m (Q4)	Unemployment to rise just 40,000 in 2010[11], then up fairly mildly in 2011 (up only 90,000).
Govt Borrowing (PSNB)	£145.0bn (2010/11)	£118.0bn (2011/12)	Govt. borrowing to fall by about £27bn (about 1.8% of GDP) in year beginning April 2011.
CPI inflation (Q4 in each year)	2.8% and RPI inflation to be 4.2%	2.5% and RPI inflation to be 3.5%	Inflation still to return within 1pp of CPI target by end-year. RPI inflation to slow by over 1pp (from 4.6% in year to Sept) by end of 2011.

Source: average latest revised UK forecasts, from HM Treasury's survey of independent forecasts (published by the Treasury in October 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. This could come from weak consumer spending, weak investment or from an economic shock from the Eurozone.

The UK economy can grow; consumer spending growth can be lifted by growth of employment, and provided there are no further significant drops in real earnings. Consumer spending can be expected to

[7] Caution: these ONS preliminary estimates are always based on very incomplete data.
[8] Known in the National Accounts by the Treasury code ABJR, in Economic & Labour Mkt Trends Oct 2010.
[9] And by 5.0% between 2008Q1 and 2009Q3.
[10] Q2 data on consumer spending are not yet available from ONS website.
[11] TWRI calculation on the assumption that forecasters use UK seasonally adjusted unemployment. This was about 1.473m in Sept 2010.

grow a bit more slowly than the overall economy, as households limit their debts. Investment, which dropped by a remarkable fifth in the recession, should pick up.

There is no economic rule that public sector job losses will be replaced by private sector expansion.

The indications are that Tyne & Wear could lose around 15,000 jobs from the public sector (from a base of around 135,000). The evidence for this is threefold;
the House of Commons Library figures were around 13,500[12] for TW;
the PwC report[13] suggests about 22,000 from the NE public sector. It estimates this swells to 43,000 NE losses when combined with private sector losses;
the OBR estimate of 490,000 public sector job losses across the UK. If TW lost 2% of these this would be around 10,000 job losses, but the public sector is relatively large in TW.

Tyne & Wear might therefore expect to lose about 25,000 jobs (about 5%) of its total employment (by 2014/15), due to the fiscal squeeze. Some of these losses, however, can be expected to be offset by growth in the rest of the private sector.
Note: the actual job losses will vary according to the budget impacts on particular departments and institutions. For example, in TW the DWP, universities and Local Authorities may be hit differently and/or respond differently from the views set out above.

The combination of the recession (-15,000 jobs) and the fiscal retrenchment to come (-25,000 jobs) could together equate to about half the scale of job losses in the 1980s recession (when TW lost about 80,000 jobs[14]).

8. Credit Crunch[15] – recent developments

Bank Lending remains weak.

- **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%. In August, bank net lending to business actually rose by £2.5bn.
- Mortgage lending continues to grow at under 1%pa.
- Consumer credit continues to grow at under 1%pa.[16]
- **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. [As an alternative, 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.

Eurozone Govt Debt Crisis

The Eurozone Govt debt crisis has remained subdued for the last three months. The stress tests of major EU banks in July have been a success in improving confidence. They provided investors in bonds issued by banks with a great deal of information about the banks' holdings of govt bonds.

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12 The expected losses given by the House of Commons Library were 10,591 from Tyneside and 2,967 from Sunderland; this gives 13,558 from Tyne & Wear (J 23/7).
13 PwC report 'The Sectoral and Regional Impact of the Fiscal Squeeze' (Oct.13th).
14 1978-86.
15 Credit Crunch means the restriction of credit by lenders, by quantity and prices. This section covers the health of the banking system.
16 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.

This “Eurozone sovereign debt crisis” still 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. Spain has lost its AAA credit-rating. Portugal has had to make further cuts[17].
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 the very least, makes exporting for UK firms less profitable and more difficult. Fortunately, NE firms export largely to northern Europe, which has not been hit directly by the crisis.

It has also 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. If southern European countries are unable to grow their economies, the crisis can be expected to return. The current EU/IMF fund runs until mid-2013.

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).

If an economy faces deflation (falling prices), of this, central banks should loosen. According to some sources, the USA faces about a 25% risk of deflation. The eurozone has similarly low very low inflation (only around 1%).
In the USA, the Fed signalled in September that it might re-start QE if activity remained weak. With US unemployment stuck near 10% and inflation close to 1%, this seems likely.

The Bank of England faces higher inflation in the UK, so QE looks less likely here than in the USA.

[17] The Economist, Oct. 23rd. 2010.