

Outlook for the UK's economy in 2016

A report for
Irwin Mitchell



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UK POWERHOUSE



January 2016

Foreword

Welcome to the latest Irwin Mitchell UK Powerhouse report.

This new study follows on from our detailed report in October 2015 which analysed the government's high profile wealth spreading agenda and in particular its 'Northern Powerhouse' initiative.

You may recall that the findings highlighted that the gap between London and other regions of the UK was in fact set to widen in the next 10 years. Indeed by 2025, the report predicted that London's economy will have grown by 27% whilst the so called 'Northern Powerhouse' was set to grow by 14%.

There have been numerous policy announcements in the last few months in relation to driving growth outside of the South East and it's good to see that some of the report's recommendations are already being introduced.

Much more however needs to be done to drive substantial growth across the UK whilst making sure London remains as a global powerhouse.

The Powerhouse Tracker which informed much of our initial report is something we have returned to in this quarterly report.

Together with the Centre for Economic and Business Research (Cebr), we have analysed growth in the 12 months up to September 2015 across 40 UK cities. We want to see how they are performing compared to each other and whether 'powerhouses' are indeed developing.

As we are at the start of 2016, it also seems a good time to look at what the next 12 months have in store for our cities and regions.

We hope that you find the findings of this report interesting and I certainly look forward to receiving your feedback in the near future.



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Irwin Mitchell's Powerhouse Tracker

Official economic data sources for the UK's cities are often dated – the last set of regional economic accounts corresponds to the economy in 2014. To more accurately estimate current economic activity, Cebr has utilised a

range of more timely indicators to create a 'nowcast' of GVA and employment for a range of key cities across the UK. These latest outputs give us a picture of how the regional economies of the UK are performing in 2015.

The results of the latest interactive Powerhouse Tracker can be viewed at www.irwinmitchell.com/ukpowerhouse

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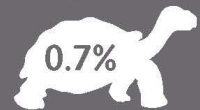
Key Facts

UK economy

Improved Q/Q in Q3 2015



Slowdown from Q2 2015



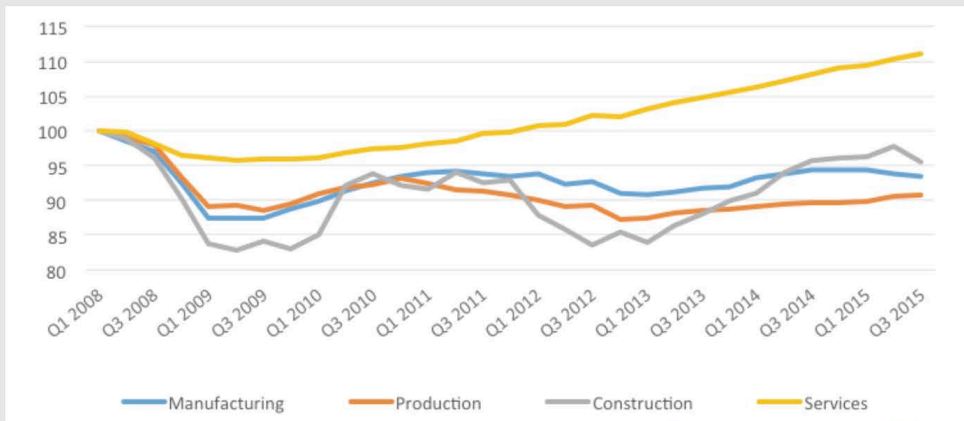
UK economy continues to grow, but headwinds emerging

The UK has been in a period of relatively strong and steady growth since the beginning of 2013. However, growth has showed some signs of gradually slowing, dropping in the latest quarter. According to the Office for National Statistics' second estimate of UK GDP, the economy expanded by 0.5% quarter-on-quarter in Q3 2015, down from the 0.7% expansion in Q2. While overall growth remains fairly strong, the underlying picture facing the different sections of the economy is mixed. The service sector continues to provide the majority of the growth seen in recent quarters, rising 0.7% compared with the previous three month period in Q3 2015. In contrast, other key sectors contracted in

the latest quarter. For instance, manufacturing output fell 0.4% in the third quarter – the third consecutive quarter of negative growth in the sector. Similarly, the construction sector saw output fall by 2.2% compared with the previous quarter.

The disparities seen in the various sectors reflect the nature of the growth drivers for the UK economy. Weak world trade growth and a strong pound have limited the ability of the UK to export its way to growth – a trend that looks likely to continue. While government and business investment have often supported growth, they have rarely been the main driver.

Figure 1 – UK GDP output components growth, indexed so Q1 2008 = 100



Source: Office for National Statistics, Cebr analysis

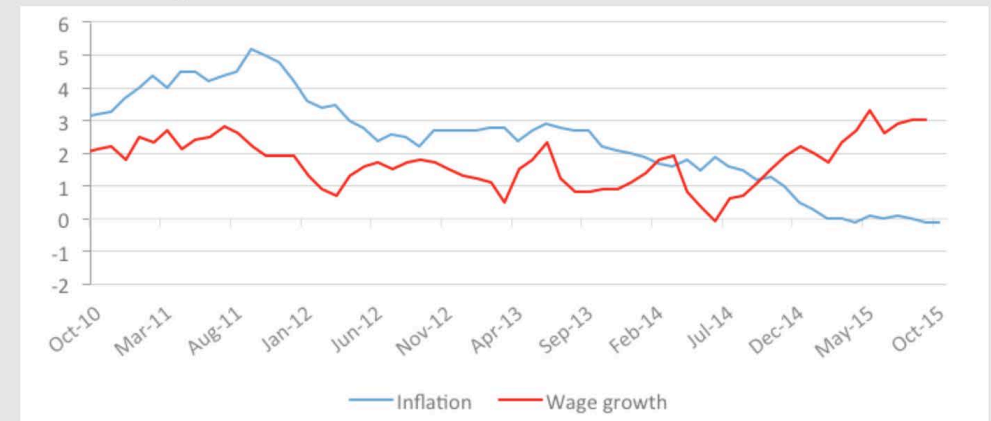
Instead, the UK has been largely reliant on household consumption to drive growth, consistently contributing 0.5 percentage points to the quarterly rate of growth each quarter since the beginning of 2015. The picture for households over the past year has been particularly positive. The domestic labour market has recovered strongly, with unemployment across the UK falling to just 5.3% in Q3 2015 and employment levels standing at all-time highs. More recently, the tightening of the labour market has placed upward pressure on wage growth, which accelerated sharply from the second half of 2014 and stood at 3% year-on-year in Q3 2015.

With inflation hovering around zero for almost the whole of 2015, this increase in wage growth has led to a considerable increase in the purchasing power of UK households. With consumer confidence, as measured by the YouGov/Cebr Consumer Confidence Index, holding relatively steady at some of the highest levels since the measure began, this additional spending power has

supported an increase in household consumption and continued growth in the wider economy. While inflation is expected to pick-up in the coming year, the latest Quarterly Inflation Report from the Bank of England (released in November) shows that headline inflation is expected to remain below its 2% target until 2017. As such, with wage growth remaining, although wage growth dropped in the three months up to the end of October, UK households should continue to drive growth over the coming 12 months. However, the economy is likely to continue to cool slowly in 2016.

In recent months, business confidence has taken a hit given concerns over the global economy, as well as policy uncertainty in the UK – particularly over membership of the European Union. With reduced optimism likely to weigh on business investment, the continuation of government deficit reduction, subdued export markets and the likelihood of an interest rise, the UK economy is set to battle stronger headwinds to growth in 2016.

Figure 2 – Annual percentage change in Consumer Price Index (CPI) inflation and total wages



Source: Office for National Statistics, Cebr analysis



UK Cities in Q3 2015

	GVA			Employment	
	GVA Q3 2015, £millions (Annualised, Constant 2012 prices)	Growth (YoY)	Change in Ranking (Q3 14 - Q3 15)	Level (Q3 2015)	Annual % change
1 London	£362,589	3.1%	-	4,839,848	4.2%
2 Inner London	£243,878	3.2%	-	3,120,457	5.0%
3 Outer London	£118,711	2.8%	-	1,719,391	2.8%
4 Greater Manchester	£56,882	2.6%	-	1,235,381	1.4%
5 Birmingham	£23,003	2.5%	-	567,074	2.9%
6 Leeds	£19,869	1.9%	-	401,342	0.4%
7 Glasgow	£19,117	2.3%	-	424,592	1.8%
8 Edinburgh	£17,293	1.7%	-	331,725	1.4%
9 Manchester	£16,001	2.9%	-	427,235	2.6%
10 Bristol	£13,122	2.4%	-	326,482	0.0%
11 Aberdeen	£12,120	2.9%	-	192,787	2.4%
12 Sheffield	£11,046	1.6%	-	286,833	0.3%
13 Liverpool	£10,308	2.1%	-	267,260	3.0%
14 Milton Keynes	£10,284	3.4%	-	160,778	4.7%
15 Belfast	£9,595	1.5%	-	122,666	1.0%
16 Cardiff	£9,021	1.7%	-	207,745	0.4%
17 Bradford	£9,002	1.6%	-	216,275	1.8%

The retail sector is an important element to urban economies, with most city centres playing a fundamental role as a centre for shopping. As such, growth in household consumption has been a major driver of economic activity for many cities across the UK.

In line with the UK as a whole, each city covered by the City Tracker has recorded positive economic growth, in real GVA¹, over the past 12-months. However, as shown in Figure 3, the rates of growth seen across the cities vary quite considerably.

On a regional basis, cities within London and the South East tend to find themselves amongst the strongest growing. Cities in the East of England have also grown relatively well over the past 12 - months led by Greater Manchester, which finds itself in the top five fastest growing cities. This is in sharp contrast to regions such as the North East, Yorkshire & Humber and the devolved nations, where many of the slowest growing regions are based.

18 Newcastle	£8,857	2.0%	-	216,680	1.4%
19 Cambridge	£8,506	3.0%	-	132,264	1.5%
20 Nottingham	£7,941	2.7%	+1	233,947	3.8%
21 Oxford	£7,932	2.5%	-1	120,631	-0.1%
22 Coventry	£7,123	2.3%	-	166,244	2.2%
23 Leicester	£7,042	1.8%	-	190,040	1.9%
24 Derby	£6,808	2.1%	-	142,020	1.8%
25 Brighton	£6,720	2.5%	-	139,484	1.5%
26 Southampton	£5,719	2.4%	-	147,064	1.3%
27 Portsmouth	£5,312	2.2%	-	113,433	-0.2%
28 Peterborough	£5,309	2.4%	-	108,377	1.1%
29 Sunderland	£5,264	1.8%	-	113,737	-0.2%
30 Plymouth	£5,107	1.8%	-	140,552	0.4%
31 Hull	£4,957	1.8%	-	135,405	0.0%
32 Stoke-on-Trent	£4,832	2.1%	-	106,464	5.2%
33 Wolverhampton	£4,581	1.8%	-	114,048	1.9%
34 Bournemouth	£4,473	2.7%	-	92,506	4.8%
35 Swansea	£4,344	1.7%	-	119,952	2.4%
36 Ipswich	£4,116	2.4%	-	76,639	1.1%
37 Norwich	£3,277	2.0%	-	116,065	-1.9%
38 Middlesbrough	£3,224	1.3%	-	67,665	-0.2%

Source: Office for National Statistics, Cebr analysis

Middlesbrough sits at the bottom of the growth rankings in the third quarter of 2015 – with GVA estimated to have risen by 1.3% compared with a year ago. Heavy manufacturing has been a notable sector that has weighed on growth in the area, with sectors such as the steel industry struggling against cheap imports and low levels of global demand.

Gross value added (GVA) is a measure of the value of goods and services produced in an area.

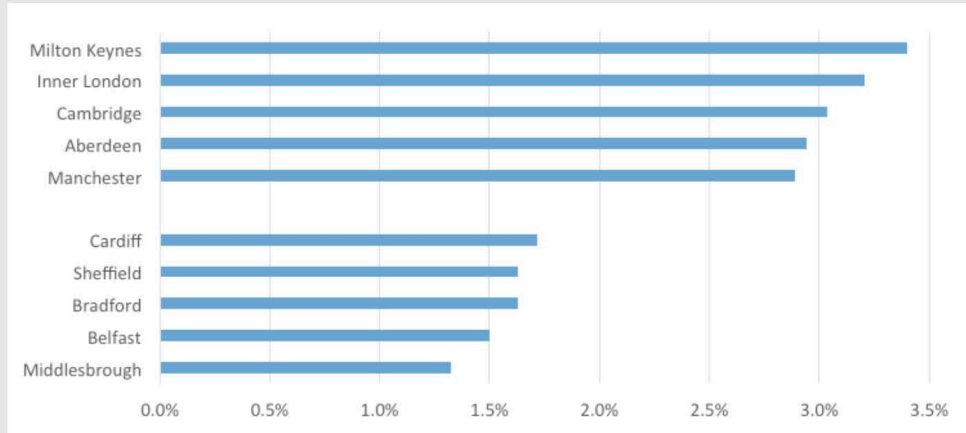
Key Facts

Pressure on heavy industries such as steel has weighed on the growth of Middlesbrough, which brings up the rear in the third quarter – a trend unlikely to notably reverse in 2016.

↑
1.3%



Figure 3 – Top and bottom five cities by annual GVA growth in Q3 2015



Source: Office for National Statistics, Cebr analysis

Belfast, Bradford, Sheffield and Cardiff also find themselves in the bottom five cities by GVA growth in the latest quarter. A combination of weak growth across important industries within the manufacturing sector and the high share of public sector employment in these areas have held back economic activity in these cities relative to others across the UK.

At the other end of the scale, Milton Keynes has seen very buoyant growth over the past 12 months. In Q3 2015, output across the city was up 3.4% on the same quarter a year earlier. The city continues to grow at strong rates supported by continued investment and strong growth in sectors such as business services, retailing and more advanced engineering, which has not experienced the declines seen in heavier manufacturing such as metal and tool production.

London lagged slightly behind Milton Keynes in terms of growth in the third quarter. The capital's economy expanded by 3.1% year-on-year. This was led by Inner London, which grew by 3.2% compared with the 2.8% recorded in Outer London. In recent quarters, the strong growth in London has not been led by sectors such as financial services and insurance. Instead, the capital has been the beneficiary of strong growth in sectors such as business services and Information and Communications Technology ICT.

Despite the sharp fall in oil prices since the middle of 2014, Aberdeen – the home of the UK's oil industry – sits within the top five cities by growth. While the city has certainly been impacted by the fall in prices and associated cost cuts in the oil industry, output in the sector has grown strongly compared with the same period a year ago as extraction has been less disrupted

by maintenance. Activity in the city is also being boosted by the spending on decommissioning offshore platforms – about £50bn of investment will be needed to decommission old rigs in the North Sea in the coming decades.

With each city economy growing, there were few changes in the size of the cities by GVA compared with the same period a year ago. Just two cities changed position, with Nottingham narrowly overtaking Oxford in terms of output over the past 12-months supported by growth in the retail sector, growth in other service sectors and investment in scientific industries such as life sciences.

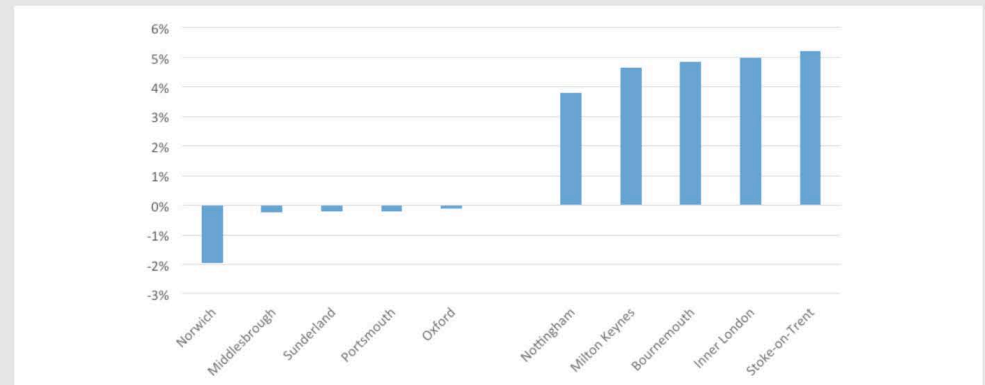
While employment growth and economic expansion are linked, the fastest growing cities do not necessarily lead the way in terms of job creation. For instance, output in Norwich has grown at over 2% over the past year but employment levels have declined, in part reflecting the tightness in the region's labour market, with

unemployment across the East of England already at very low levels.

Similarly, despite Stoke-on-Trent growing at a slower rate than cities such as London in GVA terms, employment in the city has grown at one of the fastest rates seen over the past 12 months. This growth follows a considerable period of contraction in employment levels between 2011-2013 and is reflective of the strong growth in employment levels across the West Midlands as a whole between Q3 2014 and the latest quarter.

Bournemouth, which has seen a relatively strong year of output expansion, also finds itself in the top five cities by employment growth. This follows from a year of double digit growth in employment through 2014 suggesting the city's labour market has built up some strong momentum over the last couple of years. This is similar to the labour market picture in Inner London, where employment growth of 5% in the past 12-months follows a considerable increase through 2014.

Figure 4 - Top and bottom five cities by annual employment growth in Q3 2015



Source: Office for National Statistics, Cebr analysis



Outlook for 2016

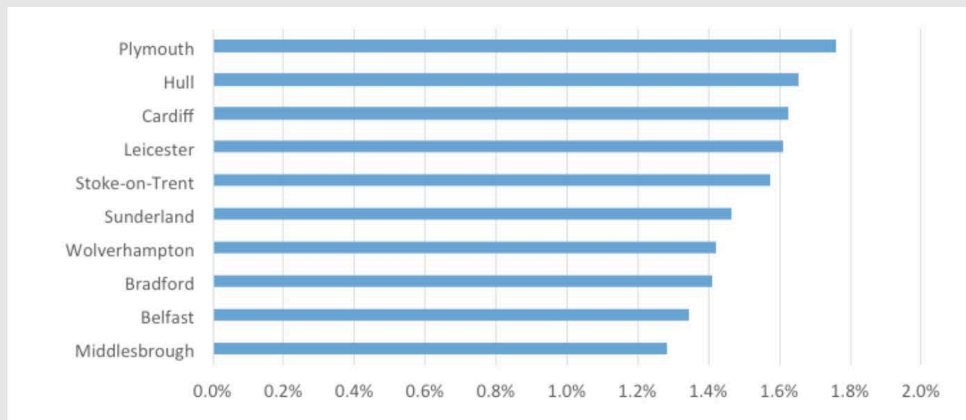
As covered in the first section, the UK economy appears to have lost some momentum in the second half of 2015 and growth in 2016 is likely to come in slightly slower than in 2015. However, growth should look broadly similar to that seen over the past 12-months, particularly on an industry basis.

Services once again look set to provide the main catalyst for growth in 2016, with broad growth projected across the sector and particularly robust rates of expansion continuing in areas such as business services and ICT. Construction should also contribute towards growth in 2016, though the sector is likely to expand at a slower rate than the service sector.

The outlook for production and manufacturing is less rosy. With global growth slowing and commodity prices remaining weak, the overall production sector is likely to find it difficult to find much expansion through 2016. Manufacturing activity is also likely to remain relatively subdued as growth in the Eurozone – a key export market – is frail. The strength of the pound against a number of currencies is also holding back export competitiveness.



Figure 5 – Bottom ten cities by projected GVA growth in 2016



Source: Office for National Statistics, Cebr analysis

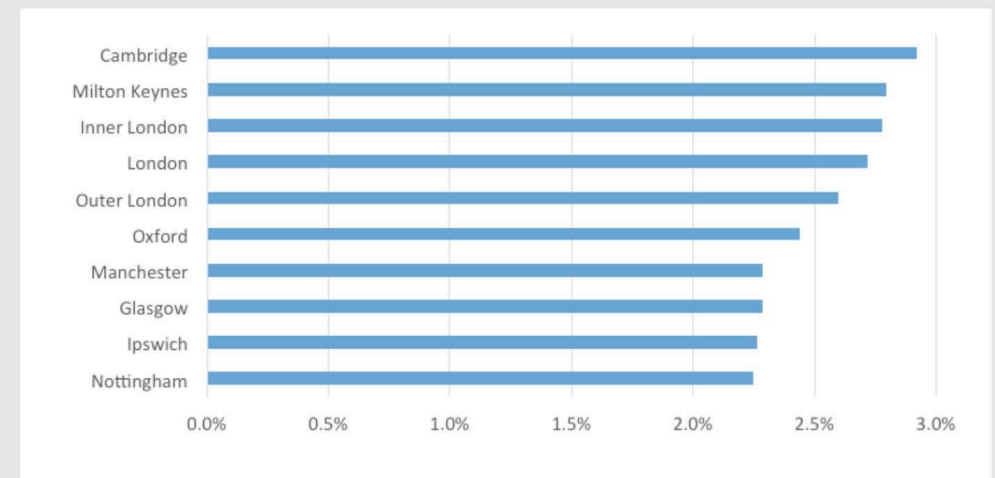
With a continuation of the current growth path looking likely in 2016, the prospects for the UK’s cities should not change drastically over the coming 12-months. In fact, the set of slowest growing cities in 2016 looks very similar to the current picture in Q3 2015. Apart from Plymouth in the South West, the bottom ten for projected GVA growth in 2016 are all outside of the South of England – with cities from the Midlands, North East, Yorkshire & Humber and Northern Ireland making up the rest of the group.

Middlesbrough once again finds itself at the bottom of the rankings. Middlesbrough remains a stronghold for heavy industry and engineering based manufacturing. The continued pressure on key commodities places a strain on a range of the manufacturing industries in the North East, with the steel industry and suppliers to the oil and gas industry both facing tough times.

The reliance on other subdued industries within production and manufacturing is also a key factor behind the relative weakness of growth in many of the other regions in Figure 5.

At a city level, growth in a number of cities should be supported by recent agreements on the devolution of power to newly elected mayors. The deals unlock considerable funds to help boost investment and long-term growth in a number of these cities. However, to some extent, the impact won’t be fully realised in 2016. As such, cities such as London, Cambridge and Milton Keynes look likely to record some of the strongest levels of output growth over the coming year driven by the growth of the service sector, their relative advantage in the manufacturing industries in which they operate and continued investment into these cities.

Figure 6 – Top ten cities by projected GVA growth in 2016



Source: Office for National Statistics, Cebr analysis



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Authorship and acknowledgements

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