City Growth Tracker

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The challenges of an economic slowdown

A report for
Irwin Mitchell

Cebr

April 2016

Foreword

Welcome to the latest Irwin Mitchell UK Powerhouse report.

This latest UK Powerhouse report comes at a time of significant economic and political uncertainty.

Our previous report in January analysed city economic growth in the third quarter of 2015 and provided a forecast for what is likely to happen in 2016.

At the time, the economy was performing reasonably strongly and although some of our largest cities revealed healthy growth and job creation, there were signs that the headwinds were getting stronger for the 12 months ahead.

The message from this latest study is that economic growth has slowed again with business confidence and investment levels falling. When the influence and uncertainty caused by the EU referendum in June is added into the equation, it's clear that the commercial environment has become even more challenging.

One of the key aims of our UK Powerhouse reports is to provide a timely look at how city economies are doing whilst also assessing the effectiveness of the Government's wealth spreading agenda.

So far, it appears that very little headway is being made. Many of the slowest growing places are located in the 'Northern Powerhouse' and indeed the forecasts point to the gap between the North and the South East getting even wider. We certainly welcome some of the announcements in the latest Budget and look forward to seeing how they impact on future wealth and job creation.

Although much is made of closing the North / South gap, it is important to remember that a strong London economy is vital to the UK economy as a whole. No one can argue against the importance of ensuring wealth is spread widely, but it's important to remember that our 'global powerhouse' in London is vital.

Looking towards the London Mayor elections on the 5th May, we have incorporated a section in this latest report to assess what is in store for our capital city and what the main challenges facing the two candidates are. Our city tracker showed a significant fall in GVA within Inner London and together with Cebr, we look at what the pressing concerns will be in the new Mayor's in-tray.

We hope that you find this section along with the rest of the 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 outdated - 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. The latest outputs of this give us a picture of how the regional economies of the UK performed in 2015.

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

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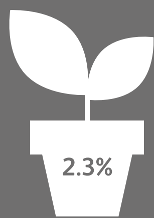
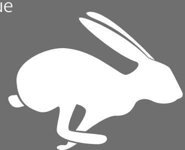
Key Facts

UK economy expanded by 0.6% quarter-by-quarter in Q4 2015. This meant that the UK grew by 2.3% across 2015 as a whole.



Milton Keynes once again led in terms of GVA growth in Q4 2015 although Inner London dropped out of the top five as output in financial services fell-back.

London looks set to continue to grow faster than the UK economy in the coming years but continued population expansion provides a number of challenges for the next Mayor of London.



* GVA: Gross value added (the value of goods and services produced)

Annual growth in UK economy falls to slowest rate since 2013 and could slow further

The UK economy grew by a solid 0.6% quarter-on-quarter in Q4 2015, a similar rate to that seen through the early quarters of the year. However, GDP growth has progressively slowed on an annual basis, standing at 2.1% in the latest quarter. This is down from the recent peak of 3% year-on-year in Q2 2014 and the lowest rate since 2013.

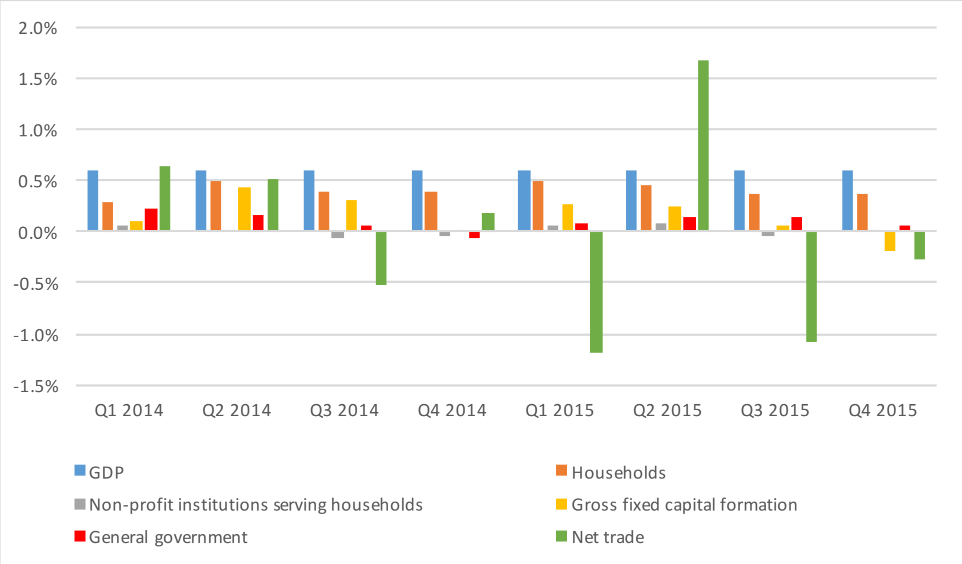
Growth remained largely dependent on household spending and the UK's services sector over the final quarter of the year. Output in the service industries increased by 0.7% in the final three months of the year, above the rate of the economy as a whole and the twelfth consecutive quarter of positive growth. Household consumption increased by 0.6% in Q4 2015, the tenth consecutive quarterly increase. As shown in Figure 1, in expenditure terms, consumption was the only consistent and notable driver of overall GDP growth through 2015 as a whole.

In contrast, net trade, the difference between exports and imports, once again provided a drag on overall growth, with export growing much more slowly than imports. The construction and manufacturing industries saw notably slower growth than the services sector. Finally, business investment fell at its sharpest pace in almost two years, a concerning sign for future improvements in productivity, profits and the sustainability of the economic recovery.

Given the nature of the UK's growth, there appears to be little that will support a recovery in growth rates in 2016. While it looks to be another strong year for consumer spending, supported by low inflation, rising earnings and credit growth, other elements will continue to weigh on growth in the coming year.

The global economy appears to be slowing, led by weaker growth in emerging markets such as China. Within this, global trade growth, which has already been structurally lower than the levels seen in the year prior to the financial crisis, looks set to be squeezed further, denting any prospect of an export-led boost in 2016. Further, a combination of turbulence in global financial markets and the uncertainty surrounding the upcoming UK referendum on EU membership already appears to have hit business confidence and investment levels and will likely constrain this driver of growth though the first half of 2016 at the very least. As such, growth in 2016 looks likely to remain reliant on consumer spending. Given this and other drivers of growth showing signs of weakness, we expect overall growth to slow from 2.3% across 2015 as a whole to 1.7% through 2016, the slowest rate of growth seen since 2012.

Figure 1 – GDP components, contribution to quarterly economic growth



Source: Office for National Statistics, Cebr analysis

UK cities in Q4 2015

Once again, each city covered by the City Growth Tracker recorded positive economic growth in real GVA[1] over the past 12 months, in line with the expansion of the UK economy as a whole. Similarly, with UK GDP growth sliding to 2.1 % in the final quarter of the year, many of the city economies saw annual GVA growth slow over the final three months of 2015.

Whilst the struggles in sectors such as manufacturing and construction continued, low-level estimates showed output in finance and insurance contracting in the past 12 months. Turbulence in global financial markets and falling business investment levels have weighed on this section of the UK economy and growth in a number of key cities over the past year. For instance, while Inner London's reliance on financial services has fallen in recent years, growth there has slipped, taking it outside of the top five cities in terms of GVA growth this quarter. Still, London as a whole continues to expand above the rate of the UK, supported by a particularly strong performance this quarter across Outer London. With less growth momentum in other parts of its economy compared to London, Edinburgh, another important financial hub in the UK, has seen annual GVA growth slip into the bottom five cities. This is in part due to the slowing of the financial sector of the city's economy.

Outside of finance, the continued challenges faced across the production sector of the economy has clearly weighed on the output growth of a number of cities, many located within the North of England and the 'Northern Powerhouse'.

Key Facts

Year-on-year GVA growth

Inner London fell to **1.9%** ↓

Outer London grew to **2.6%** ↑

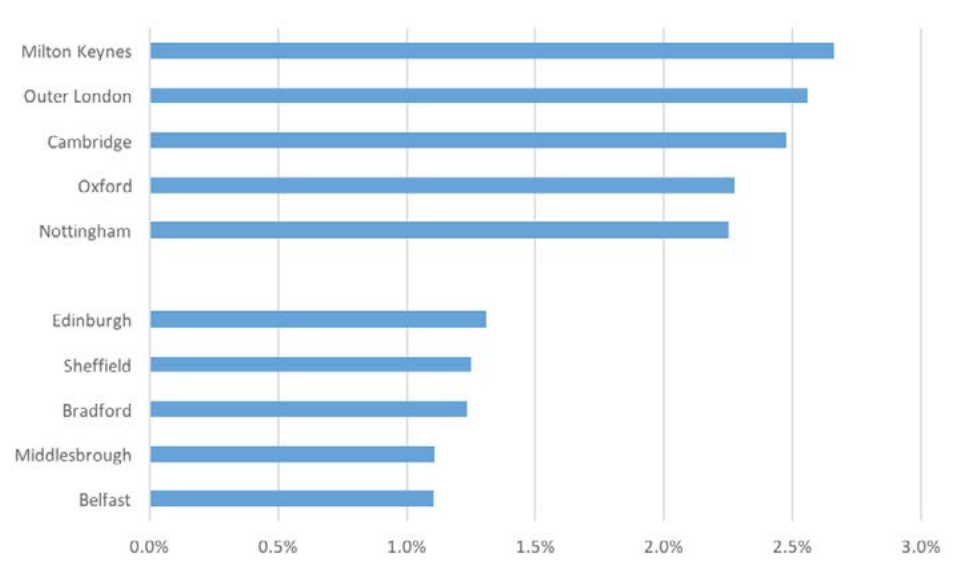
1 Gross value added (GVA) is a measure of the value of goods and services produced in an area.

City growth league table

GVA				Employment		
League table ranking (arrows indicate change in position since last quarter)		GVA Q4 2015, £millions (Annualised, Constant 2012 prices)	Growth (YoY)	League table ranking (Change in position since last quarter)	Level, Q4 2015	Annual % Change
1	Milton Keynes →	£10,317	2.7%	Stoke-on-Trent →	110,261	7.4%
2	Outer London →	£119,393	2.6%	Bournemouth ↑1	94,022	6.8%
3	Cambridge →	£8,525	2.5%	Milton Keynes ↓1	163,352	6.5%
4	Oxford ↑2	£7,969	2.3%	Southampton ↑3	151,865	4.8%
5	Nottingham ↑4	£7,976	2.3%	Birmingham →	585,030	4.6%
6	London ↓1	£363,336	2.1%	Liverpool ↑1	273,201	4.4%
7	Manchester ↑2	£16,042	2.1%	Nottingham ↑2	238,584	4.1%
8	Aberdeen ↓1	£12,094	2.0%	Glasgow ↓4	434,969	3.5%
9	Greater Manchester ↑3	£57,028	2.0%	Inner London ↓5	3,061,122	3.5%
10	Birmingham →	£23,058	2.0%	London ↓2	4,766,718	3.1%
11	Coventry ↑5	£7,148	1.9%	Greater Manchester →	1,263,323	2.8%
12	Inner London ↓4	£243,942	1.9%	Leicester ↓2	194,415	2.6%
13	Portsmouth ↑2	£5,332	1.9%	Outer London ↑5	1,705,596	2.5%
14	Ipswich ↑3	£4,130	1.9%	Belfast ↑3	124,785	2.4%
15	Bournemouth ↓4	£4,478	1.9%	Peterborough ↓2	109,255	2.4%
16	Southampton ↓3	£5,739	1.9%	Newcastle →	222,074	2.2%
17	Liverpool ↑3	£10,368	1.9%	Manchester ↓2	429,307	2.2%
18	Brighton ↓4	£6,734	1.9%	Coventry ↓4	168,588	2.1%
19	Peterborough →	£5,324	1.8%	Swansea ↑3	119,742	2.0%
20	Cardiff ↑5	£9,095	1.8%	Leeds ↑1	408,905	2.0%
21	Leeds ↑4	£20,006	1.7%	Hull ↑5	138,356	1.8%
22	Newcastle ↓1	£8,891	1.7%	Norwich ↑11	119,627	1.6%
23	Hull ↑6	£4,976	1.7%	Edinburgh ↓5	334,641	1.6%
24	Plymouth ↑12	£5,126	1.6%	Bradford ↑1	216,351	1.5%
25	Stoke-on-Trent ↑3	£4,837	1.6%	Cambridge ↓4	131,524	1.4%
26	Bristol ↓8	£13,144	1.6%	Ipswich ↑2	76,410	1.3%
27	Leicester ↑5	£7,064	1.6%	Brighton ↓5	138,820	1.2%
28	Glasgow →	£19,132	1.6%	Wolverhampton ↓1	114,813	1.0%
29	Swansea ↑1	£4,364	1.6%	Oxford ↑3	121,813	1.0%
30	Norwich ↓7	£6,211	1.5%	Middlesbrough →	69,611	0.9%
31	Wolverhampton ↓5	£4,598	1.5%	Derby ↓2	143,158	0.9%
32	Sunderland ↑2	£5,279	1.5%	Aberdeen ↓9	191,085	0.8%
33	Derby ↑5	£6,809	1.5%	Bristol ↓2	327,918	0.7%
34	Edinburgh ↓1	£17,408	1.3%	Plymouth →	140,231	0.4%
35	Sheffield ↓4	£11,083	1.2%	Sunderland ↑1	116,083	0.1%
36	Bradford ↑1	£9,025	1.2%	Portsmouth ↑1	113,545	0.1%
37	Middlesbrough ↑1	£3,235	1.1%	Cardiff ↓2	207,564	0.0%
38	Belfast ↓3	£9,633	1.1%	Sheffield →	285,815	-0.4%

Source: Office for National Statistics, Cebr analysis

Figure 2 - Five fastest and slowest expanding cities by year-on-year GVA growth in Q4 2015



Source: Office for National Statistics, Cebr analysis

Having found itself in the bottom five in Q3 2015, Belfast appears at the bottom of the rankings in terms of GVA growth over the past 12 months. The latest FSB Small Business Index showed confidence among small businesses in Northern Ireland has dropped into negative territory, suggesting a deteriorating outlook for Belfast. This will not be helped by the recent announcement of job losses at Bombardier, the Canadian aircraft and rail manufacturer, who have a factory in East Belfast. The company is a major player in the province's manufacturing sector, with its operations accounting for around a tenth of Northern Ireland's manufactured exports.

At the other end of the scale, Milton Keynes remained in top spot in terms of GVA growth, seeing further buoyant growth in the year to Q4 2015. Business services and the overall retail sector, important elements in the city's economy, continue to record strong rates of output growth.

While manufacturing across the UK saw weak growth in the final three months of the year, vehicle manufacturing has provided a notable exception to the overall picture across the sector, recording its fifth consecutive quarterly increase in output. The performance of the motoring industry has helped to support GVA growth in a number of cities including Birmingham, Coventry, Oxford and Sunderland.

Leeds saw annual GVA growth of 1.7 % in Q4 2015, down from 2 % in the third quarter of the year. The economy of Leeds is relatively diversified. Services dominate over traditional manufacturing industries but Leeds is still home to a range of small and medium sized manufacturing firms, responsible for around 7 % of employment in the city. As with the UK economy as a whole, services provide the primary driver of growth in the city's economy, though, as one of the leading financial service centres outside of London, the slowdown in financial and insurance services has begun to dent growth in the latest quarter. Still, growing employment in areas such as legal and accountancy services, HR and IT is helping to support growth in the absence of a flourishing financial sector.

Despite a varied range of growth rates across the cities covered over the past 12 months, there were no changes in the rankings in terms of overall GVA. However, while there were no overall changes, the gaps between the cities have moved over the past year. The most notable narrowing over this period was seen between Manchester and Edinburgh, with the former notably closing the gap as a result of an annual growth rate that placed Edinburgh in the bottom five in the latest quarter.

Key Facts

Performance Growth

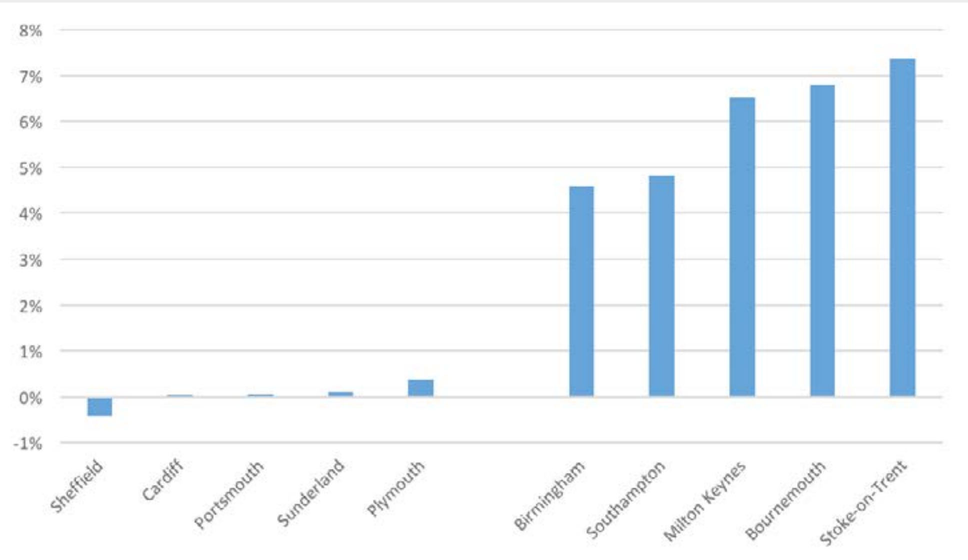
Vehicle manufacturing saw an increase in output for the **5th** consecutive quarter

As noted previously, the fastest growing cities do not necessarily lead the way in terms of job creation, with job growth in some places high as the city's labour market recovers and slow in others because increasingly tight regional labour markets exert pressure on the availability of skilled workers.

Stoke-on-Trent once again finds itself in the top five cities in terms of employment growth despite sitting within the middle of the pack in terms of GVA growth. The city's labour market continues to recover from a prolonged period of employment contraction, though growth may come under pressure as key manufacturing industries remain under pressure.

Sheffield finds itself at the bottom of the table in terms of employment growth in Q4 2015, with employment contracting over the past 12 months. Manufacturing forms an important section of the city's economy. While steel no longer dominates, the well-documented issues within the UK's steel industry has been one factor weighing on employment across the city, much as it has done in other areas of the UK not covered by the CityTracker. In addition to private sector job cuts, Sheffield has also increasingly seen public sector employment come under pressure and further job cuts in the City Council have already been announced.

Figure 3 – Top and bottom five cities by annual employment growth, Q4 2015



Source: Office for National Statistics, Cebr analysis

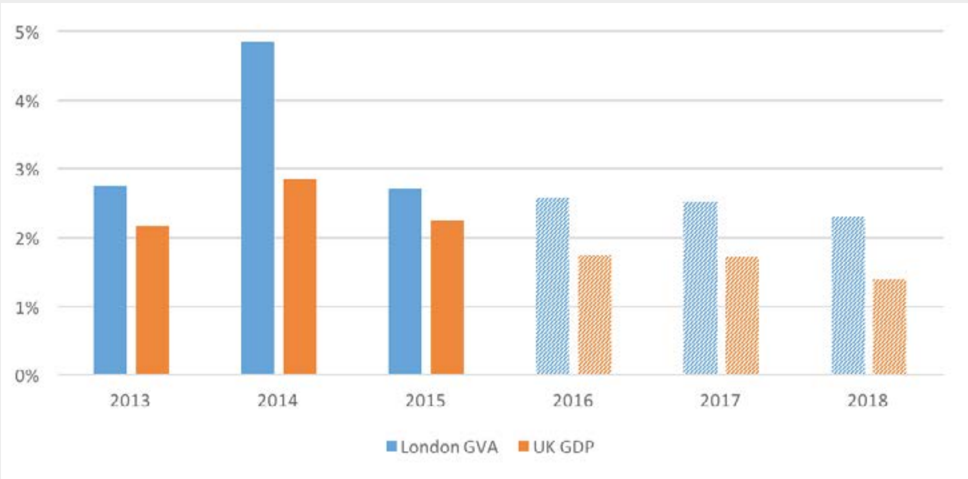
London: a global powerhouse

Despite being one of the foremost global financial centres, London's economy has continued to flourish since the financial crisis of 2008/09. London continues to be seen as a pre-eminent global business location; the latest Global Financial Centres Index, published by Z/Yen Group and the Qatar Financial Centre, saw London jump ahead of New York to reclaim the top spot. The report sees London lead in a range of important areas including the business environment, infrastructure and human capital.

However, while financial and business services remain the predominant sectors across the capital, recent years have seen a notable diversification of London's economy.

The development of the internet and technology has created a new wave of opportunities, with businesses emerging across the capital forming new hubs for these sectors. The 'Flat-White Economy', a term coined by Cebr after the drink synonymous with the young workforce, consists of a range of businesses within media, internet, ecommerce and creative industries. While comparatively still only employing around 60% of the number of workers employed in London's financial services sector in 2014, the number of people employed within the 'Flat-White' Economy rose by 40% between 2009 – 2014. This compares with a 24.2% rise in employment within the financial services sector.

Figure 4 – Output growth in London and the UK (Cebr forecasts for 2016 - 2018)



Source: Office for National Statistics, Cebr analysis

Upcoming challenges

Just as with more traditional service industries such as finance, London's emergence as a hub for industries such as software development, creative media, advertising and market research has been supported by factors such as the attractiveness of the city to young, educated workers across the globe and the associated supply of tech-savvy, skilled workers. However, the rapid growth in population and workforce does not come without its own set of challenges. The new Mayor will need to make moves to address these issues in order to ensure the sustainability of London's economic expansion, particularly as parts of the capital's infrastructure are already being placed under notable strain.

London's population rose by just under 15%, equivalent to more than 1.1 million people, between 2004-2014 and with around 9 new residents every hour, it is projected to rise from about 8.6 million today to around 10 million by 2030. This rapid population growth has already led to considerable issues with regards to housing London's ever expanding workforce, and has subsequently contributed to the capital's well-documented housing crisis. With further population growth expected to put upward pressure on housing costs, the rising cost of housing across London and surrounding counties threatens to stunt the current growth trajectory of the region based on current trends.

The central projection in the GLA's strategic housing market assessment (SHMA) indicates that London will require an average of 49,000 more homes each year between 2015-2036, though 62,000 more homes a year may be required over the next decade in order to address the current backlog. As of 2013, the GLA's strategic housing land availability assessment (SHLAA) had identified more than three quarters of the land required for the development of 49,000 homes per year through to 2025. However, more than half a million opportunities still need to be found to meet the projections through to 2036 in addition to that needed to permit the additional 13,000 homes that may be required each year over the course of the next decade.

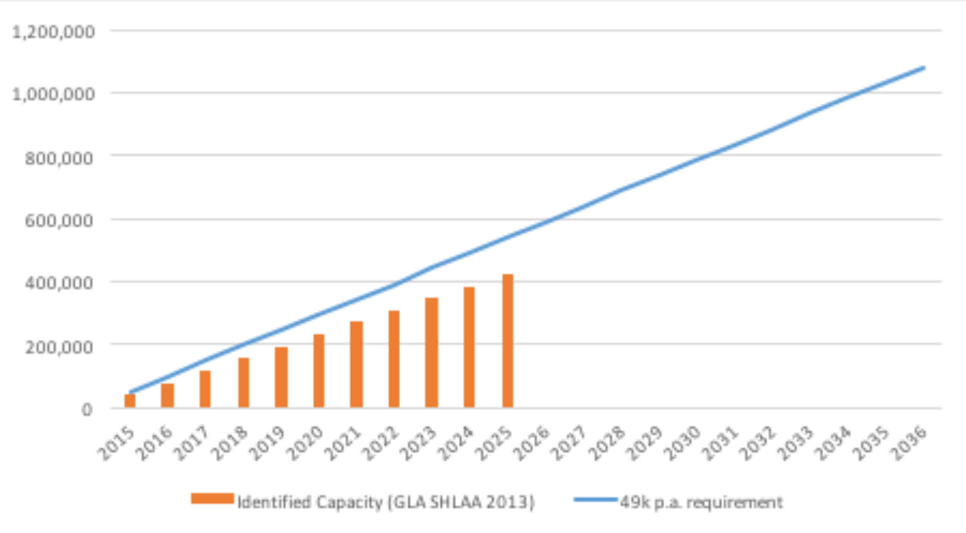
Key Facts

Employment 2009-2014

Flat white economy jobs increased by 40%

Financial services jobs increased by only 24.2%

Figure 5 – GLA projections for new housing required (SHMA) and identified capacity (SHLAA 2013)



Source: GLA, Cebr analysis

The challenges of population growth also extend into a number of other areas. To ensure that the increase in the number of people living and working in London is productive, more capacity will be needed across London's transport infrastructure. The number of trips made on London's roads and public transport has already exceeded 9.5 billion per annum and is forecast to reach around 11 billion by 2030. At almost £17 billion, transport investments currently make up nearly two thirds of the Mayor's budget but the new Mayor will have to work to secure funding for further enhancements to the network run by Transport for London. Major projects in the pipeline include Crossrail 2, the Bakerloo extension, new river crossings in East London and a variety of new road tunnels. These are in addition to national investments in rail projects such as HS2.

While transport could be viewed in isolation, it is an important factor that will enable London to meet future housing demands. Crossrail 2, a new rail line currently in the development stages, would serve London and the wider South East and provide rail capacity for 270,000 passengers to access central London during peak periods. However, the project would also enable the development of 200,000 new homes to house London's growing workforce and ease capacity constraints at key London stations such as Waterloo. With construction needing to start in 2020/2021 in order to bring the project into operation by 2030/2031, this will likely be one of the major projects to address in the Mayor's first few years.

As previously explored in our in-depth white paper last October, London's population growth is skewed compared with the typical demographic profile across the UK. In 2014, 25% of people living in Inner London and 16% in Outer London were aged 25-34 compared with just 13% across the whole of England. This demographic profile puts particular pressure in the school system, particularly at the primary level. Around 40% of the national shortage of school places are in London and with the number of school age residents in the capital expected to rise by around 17% by 2036, the upcoming Mayor is likely to need to make moves to address the current challenges facing the schooling system across London.

While London's rising population will undoubtedly leave the incoming Mayor with some key challenges to address, the upcoming UK referendum on EU membership could notably change the environment in which the Mayor will be taking steps to address these issues. The EU is London's biggest trading partner and access to the Single Market is a core reason for many of world's largest companies choosing London as the city to base their European or global headquarters. As such, EU membership is argued to be an important element underpinning the London economy. However, there are also a range of costs to businesses, policymakers and the general public associated with being part of the European Union. Not only do Londoners contribute towards the UK's annual membership cost (around £13 billion in 2015), businesses across the capital face additional costs each year in order to comply with EU regulations.

In the event of a 'no' vote on June 23rd, the new Mayor will be challenged with making sure the needs of the London economy are taken into account as the UK negotiates its exit with other EU members. Given the importance of financial services to London's economy, negotiations with regards to passporting rights, which allow a UK headquartered bank access to the Single Market, will be important in order to help maintain London's position as the most attractive global financial centre.

Global Business Location

London takes top spot

New York is now in **2nd**

Popoulation

Population grew **15%** 2004-2014

8.6M in 2014

10M in 2030

= currently +9 new residents move to London per hour

Schools

17% rise in school age residents by **2036**

when **40%** of the UK's school shortages already exist in London

Housing

From 2015-2036 **49,000** new homes will be required per year

Roads & Public Transport

Number of trips made per year

= 9.5 billion in **2015**

to increase to 11 billion in **2030**

9.5 bn trips

17Bn Transport

City Budget

£17 billion or **2/3's** of London's budget is already allocated to transport investments

Disclaimer

Whilst every effort has been made to ensure the accuracy of the material in this document, neither Centre for Economics and Business Research Ltd nor the report's authors will be liable for any loss or damages incurred through the use of the report.

Authorship and acknowledgements

This report has been produced by Cebr, an independent economics and business research consultancy established in 1992. The views expressed herein are those of the authors only and are based upon independent research by them.

London, April 2016

A report for Irwin Mitchell

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