Regional Economic Development

Business Intelligence Report 15: Autumn 2018[1]

Summary

The UK economy is maintaining sluggish, forward momentum through the second half of 2018. If anything, Q3 looks to have been a bit better than Q2. But, there is nothing to suggest a new trend has begun, for good or ill. The year ahead could be one of momentous change but, for now, it feels calm.

This mood reflects an element of 'wait and see' on the policy front as the Brexit negotiations drag on, (despite the fast approaching deadline). This affects marginal investment decisions and means option planning is paramount. There seems to be a case of the (year 2000) Y2Ks[2] going on, as well as a fear of GR2[3] (great recession 2).

This allows 'business as usual' in the near term but constrains innovation and development for the future. Despite high employment, this is not healthy for an economy already woefully short of productivity growth.

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[1] This is the latest of a regular overview series of Business Intelligence Reports that BU produces for the Dorset and neighbouring business community and its partners.

[2] The Year 2000 (Y2K) time bomb was expected to disrupt the economy, when computer systems were expected to crash because of the way date codes were inserted in key software. In the end, a lot of time, effort and money went into making sure the transition was not catastrophic and Y2K had an element of 'crying wolf'. Some see Brexit in the same vein but some surveys suggest few firms are making enough contingency for the event.

[3] Others see Brexit as a disaster waiting to happen. We are walking backwards towards the cliff edge looking inland and saying "everything I see ahead looks fine – don't panic". But, next March, we may step off the cliff into another Great Recession (GR2). Some of the UK stock market woes this autumn reflect investors' caution ahead of these risks.

Evidence & Outlook

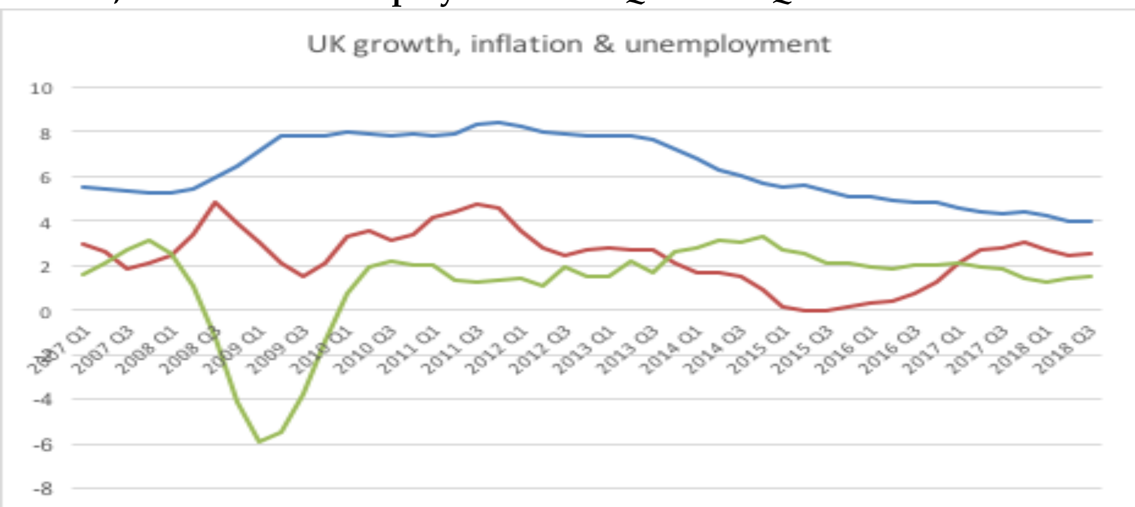
UK	Annual (2017)	Quarterly	Monthly
Real GDP (%ch 3m on prev)	+1.7	+1.3 (Q2)	+0.7 (aug, 3mth)
CPI inflation (%ch, yoy)	+2.7	+2.5 (Q3)	+2.4 (sep)
LFS unemployment (%)	4.4	4.0 (Q2)	4.0 (jun-aug)
Current Account (£bn)	-76.5	-20.3 (Q2)	n.a.
Base rate (%)	0.29	0.62 (Q3)	0.75 (nov)

Source: ONS

The UK economy (see table above and chart below) still exhibits positive but flat real growth, above target inflation, generationally low unemployment and persistent trade and public deficits. There has been something of an economic lull in recent months: more of the same with few new trends.

This could be the 'calm before the storm'. History teaches us that short-term stability often breeds vulnerability to 'shocks'. The calm will not last, but it is difficult to predict when, or in which direction, the change will occur. At the end of next March, Brexit is an obvious candidate for a potential turning point. The likelihood is, however, that markets and economic actors will move before then, if the deal/no deal outcome clarifies. Longer term effects and actions will only appear over the period of transition, and beyond, as investment and trading patterns adjust to whatever reality starts to emerge.

Growth, Inflation & Unemployment: 1989 Q1 – 2018 Q2



Source: ONS: Growth = real GDP % change year-on-year (yoy). Inflation = CPI % ch yoy. Unemployment = LFS % rate.

Meanwhile, the winter ahead looks to be another holding period punctuated by policy 'news' – fake or otherwise. A 'cold' winter is possible, with more 'sitting on hands' by key economic decision makers in the corporate sector. A balmy outlook, however, remains equally possible, with the recent pattern persisting of modest growth, reasonable inflation and low unemployment.

STRUCTURE & STRATEGY

Whatever the immediate tactical trends, the fundamental structural issues of poor productivity and competitiveness remain to be addressed. A lot of time and effort will be put into the creation of "Local Economic Strategies" (LES) over the next 18 months (including one for Dorset). If these are not to become worthy but worthless documents, (merely occupying shelf space), it is important that they are distinct, productivity and value led, and long-term.

- By distinct, we mean that the Dorset LES should not just be like all the others. It must embrace what we want the county to look like and feel like in the future, including what we want to preserve; what our actual and potential strengths and weaknesses are, and can be; and what the desired balance might be between development and conservation.

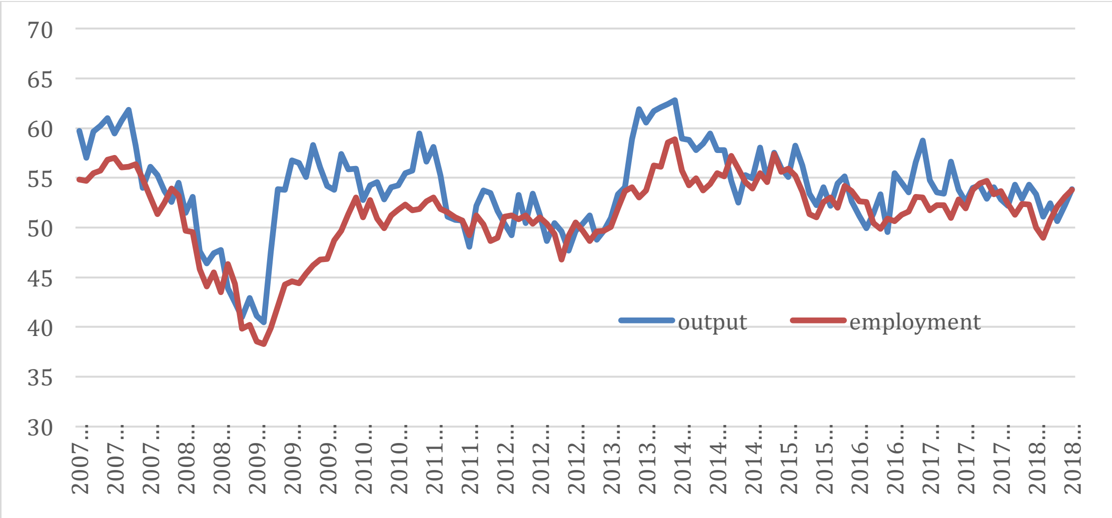
- By productivity and value led, we mean that the only way to sustain or improve living standards over the medium term is to 'do things better and do better things' and to 'co-operate in order to compete'. It is about choosing the best approach for 'how to grow' and, thereby, achieving the 'right kind of growth'. It is about developing key sectors and disseminating best practice; sharing that 'best practice' across our communities and workers, and our places and industries

- By long term, we mean the focus should be on the economy's capacity and capability for the years beyond the Brexit transition, looking towards the 2030s and the demographic, environmental and technological changes facing our children and grand-children. This requires a fresh emphasis on innovation and skills, through investment in performance and potential.

Dorset is small but distinct. It offers a 'test-bed' of intervention for a world of aging population, technological advance, environmental disruption and market transformation. At present, the Dorset economy has a small head and a long tail (rather like the plesiosaurus of local fossil record). To avoid extinction, the LES needs to set a clear programme for focussed development.

Meanwhile, in Southern England, the economies continue to 'poohtle' along. The PMI measures for September showed some improvement on mid-year for activity and employment (see chart below). We remain in a broadly sluggish milieu that has persisted since 2014. Nevertheless, SW and SE businesses remain fairly bullish about the near-term outlook, (recording positive balances well above 60 in September).

SW PMI Activity & Employment Scores 2000-18



Meanwhile, local labour markets remain tight across Dorset. Finding, holding on to, and replacing skilled labour remains a key constraint on growth, as mentioned by many firms in most business surveys.

BREXIT adds to current business uncertainty. A recent BCC survey showed around 20% of respondents expect to cut investment, move activity and reduce recruitment in the event of 'no deal'. This was sober reading.

Nevertheless, the 2018 budget was welcomed by many local business groups, not least because of its moves on business rates, investment allowances, apprenticeship levies, excise duties and personal allowances. The budget assumes, however, that a positive 'deal' is achieved – let's hope so.

STABILISATION & CONDITIONS

World and UK interest rates are low but starting to be pushed up. Quantitative easing (QE) is virtually 'over'. At long last, there is some hope that a monetary 'return to normal' is underway, even if the path to 'normality' is going to be a long one. We pray that the economy remains strong enough for base interest rates to gradually move towards 3-4% over the next few years. Done carefully, this will recreate an appropriate incentive structure for real investment; encourage better household debt management;

and remove the distortions of the post-2009 'zombie' economy. It will also make room for stabilising action to offset any economic malaise further down the line.

US-led trade wars remain a threat. It is important to remember that America is a relatively closed economy and its trade restrictions often affect more outsiders than domestics. The Trump administration is looking for a 'rebalancing' of trade relationships and flows. This is not without some logic, but it carries a threat of putting up costly barriers that negatively affect long-term demand and supply chains. (This is not really welcome for a solo UK.)

Against this background, strategic growth rather than stabilisation policies should drive future development. In particular, the United Kingdom needs to invest more dynamically in infrastructure, innovation and skills in order to boost its competiveness.

Bournemouth University

COMMENT

The local economy is stable, with persistent forward momentum. However, growth potential has withered and negative risks about future trade and investment are adding uncertainty: keeping growth sluggish.

The risk of a 'Brexit recession' is not insignificant for 2019/20. Issues of future trading relationships need to be resolved sooner rather than later.

Locally, businesses need to be aware of the potential for Y2K or GR2 effects from Brexit. Whatever comes through over the next five months, the mid-term requirement remains for attention to underlying demographic, environmental and technological trends. In turn, this implies appropriate investment in technical innovation, capital machinery and processes, workforce and skills, and market penetration.

At the end of 2018, there is scope for both optimism and pessimism about the economic future. Let's hope the balance of risks switches to the former in the months before our next briefing.

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