Is this the end of the recession?

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The UK is heading out of recession...definitely maybe

The UK is now officially out of recession. Last week, a preliminary estimate released by the *Office for National Statistics* (ONS) showed that the UK's economy grew by 0.1 percent between the third and fourth quarter of 2009[1]. Responses from business surveys are also upbeat and November and December claimant figures suggest positive signs in the labour market. Despite this, a recovery of 0.1 percent is clearly a fragile one. Germany and France started to post positive growth rates as early as June 2009, and the current recession has been longer, and more protracted, than those of the 1970s and 1980s[2]. The 0.1 percent growth rate has therefore been given a relatively lukewarm reception amongst journalists, economic forecasters and politicians.

What is threatening the UK's recovery?

There are apparently several reasons to be sceptical about whether the UK is genuinely out of recession. Firstly, consumer spending is unlikely to quickly return to pre-recession levels[3]. Value Added Tax (VAT) is back at 17.5 percent and this, coupled with a reduction in supply by the world's oil-producing countries, has meant a return to inflation[3]. At the same time, continued job losses through late 2008 and 2009 have left some surplus in the labour market. The upshot is that businesses will be able to keep wages low, and for 2010 growth in salaries is generally expected to be below that of inflation[4]. All of this will put added pressure on household budgets.

Another worry, which will dent consumer demand and market confidence, relates to the Treasury's and Bank of England's next moves. In order to maintain spending in the economy and to lessen the immediate impacts of the recession, interest rates were cut to a record level of just 0.5 percent in March 2009[5]. Inevitably this indirect stimulus will at some point need to be taken out of the economy[6]. As a consequence, mortgage repayments and the real value of other debts will increase[6].

Also of concern is how the government will sustain the recovery whilst coping with its own spending commitments. The public sector's budget deficit - the gap between what it takes in and what it gives out - for December 2009 was estimated at £11.9billion[7]. Contrary to most media reporting this is not necessarily exceptional when compared with other advanced economies[7]. However, the Treasury raises this additional money by issuing and then selling gilts to investors. In late 2009, after Alistair Darling set out his spending commitments for 2010-2011, the value of government gilts fell, suggesting a higher borrowing risk and lower investor confidence. For some, this is an indication that the UK is pushing the limits of what it can reasonably borrow, with genuine fears that current levels of indebtedness may affect the UK's credit rating[5]. As a result, tax increases, public sector cuts and an end to 'quantitative easing' will be necessary at some point in 2010 or 2011. But withdrawing the money supply too early may put the country back into recession[8].

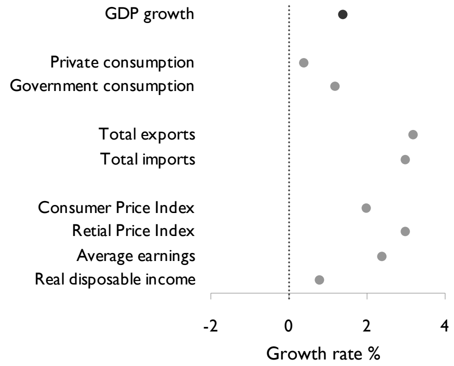
This tension between whether or not to rein in public spending and introduce tighter monetary policies is a political one. It is probably likely to define this year's General Election campaign[9].

What can forecasts tell us about 2010?

Despite these concerns, most economic forecasters seem to be cautiously optimistic about 2010 (see figures 1 and 2). Almost all assume GDP growth of around 1.0 to 1.8 percent for the year as a whole. Export growth is also expected to be strong, but this largely owing to a pick up in demand elsewhere and the fact that Sterling remains 25 percent below its 2008 value[4].

Although it may be volatile, there is likely to be some upward pressure on inflation. Importantly, growth in earnings and especially household income is expected to be more modest and generally below that of inflation. Public sector spending will be sustained through 2010, and will grow at a faster rate than private spending where growth is likely to be weak. Again it is worth restating that, with the country's growing budget deficit, cuts in public sector jobs and services will be introduced in 2011.

Figure 1 Average of growth forecasts

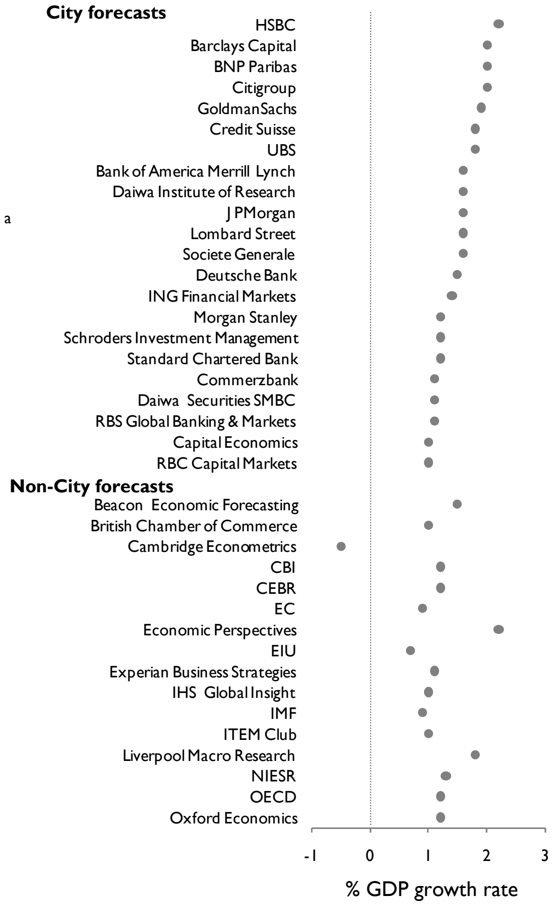


Source: HM Treasury, 2010

* Disposable Household Income takes all after tax incomes available to a household, including subsidies such as welfare and tax receipts,

Figure 1: GDP growth will recover to around 1.4 percent, private consumption will still be weaker than government consumption, exports are expected to recover ahead of imports and inflation will outstrip real disposable income.

Figure 2 GDP Growth forecasts for 2010



Source: HM Treasury, 2010

What can we claim about Leicester and Leicestershire?

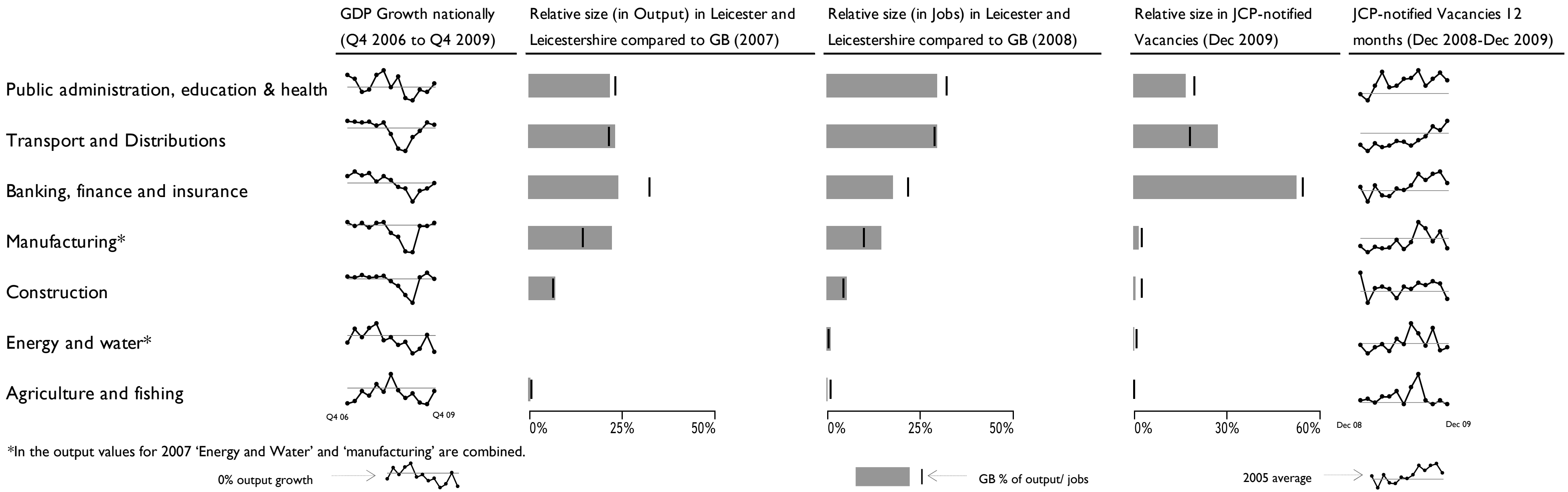
Whether or not Leicester and Leicestershire has exited out of recession is difficult to say. There are limited recent economic indicators available below national level. However, local economies are clearly not self-contained and based on historical data, output growth at the regional or sub-regional level tends to follow what is happening nationally. We can therefore expect that, if there has been an (albeit slight) recovery for the UK as a whole, this will probably have been the case in Leicestershire.

Sector structure, regional economies and the recession

Where differences do occur between local and national economies, they often relate to local sector structure[10]. Smaller economies, for example, tend to specialise in the production of certain goods and services. If an economic downturn is contained within a particular sector, then it follows that regions which depend on that sector for growth will be hit harder than others.

Figure 3 attempts to give a brief profile of Leicester and Leicestershire's economy based on recent economic indicators. It shows the importance of each sector in output and employment terms relative to the rest of Great Britain, trends in output growth

Figure 3: Leicester and Leicestershire's sector structure, output growth and labour market signals. The graphic is ordered according to the size of each sector in the sub-region



Source: ONS GDP Preliminary Estimates, 2010; ONS Regional GVA, 2007; ABI, 2008 and JCP Vacancies, 2010 nationally in each of those sectors until Q4 2009 and very recent changes in Jobcentre Plus-notified vacancies* (also by sector).

Public administration, education and health is an important sector to Leicester and Leicestershire. It takes up 25 percent of the sub-region's total employment and contributes to 30 percent of its output. One in five workers in Leicestershire are employed in public administration, education and health, and the sector contributes to 19 percent of the county's total output. Although this appears large, it is below the national average of 27 percent (in terms of jobs) and 32 percent (in terms of output). Leicester City is very significantly more dependent on the public sector for employment. Of all jobs available in Leicester City, 35 percent are within public sector. As we mentioned earlier, we can expect there to be a substantial contraction in public spending from 2011 onwards[8]. Although Leicestershire may perhaps be better placed than elsewhere (since the sector is relatively small), this is likely to have some impact on the shape and structure of Leicester City's economy.

Transport and distributions (which includes retail) is also substantial in Leicester and Leicestershire and it is overrepresented when compared nationally. Taking into account the other indicators in figure 3, this is probably encouraging. At the UK level, output growth in the sector went positive in Q3 of 2009 and, although hit hard by recession, transport and distribution vacancies in Leicester and Leicestershire did recover by late 2009.

*JCP Vacancies represent only around 30 percent of all vacancies in the sub-region and they are usually skewed towards lower-skilled occupations.

Another reason to possibly be more optimistic, looking at Leicester and Leicestershire's economic structure, is that by national standards Banking, Finance and Business Services is relatively small whilst manufacturing jobs and output is large. On the back of the financial crisis in Summer 2008, for instance, many commentators suggested that the structure of the UK's economy needed to change - that we should no longer depend on the financial services sector for growth[10]. Instead, with a weak Sterling, export oriented growth from the production sector was considered the best way out of recession[10]. This is also why it could be reassuring that manufacturing remains a significant local sector. At the same time, however, recent growth in manufacturing vacancies has been poor (figure 3). There were also relatively high profile redundancies in UK car manufacturing in late 2009[11]. And, strangely, growth in banking, finance and insurance vacancies in Leicester and Leicestershire has been mostly positive since July 2009.

Finally, construction jobs in Leicester and Leicestershire are slightly overrepresented when compared nationally. As the first indicator in figure 3 shows (quarter-on-quarter output growth), construction was a sector hit badly by the recession. This is understandable since the downturn was precipitated by a financial crisis: the construction sector depends heavily on banks extending credit to businesses and consumers. Despite this, there has already been some positive signals from construction in terms of output growth (figure 3). More anecdotally, local recruiters have said that, in a recession, construction is usually quick to react to changes in consumer demand - it tends to be the first sector to recover. That house prices in Leicester and Leicestershire have also grown month-on-month since May 2009[11] is therefore encouraging. But in terms of vacancies, there have been few local signs of an upturn, especially relative to other sectors (figure 3).

Local Business Opinions

One other useful source of local information is the Leicester and Leicestershire Business Survey. The Businesses Survey monitors the opinions of around 1,000 businesses in the sub-region. With the exception of 2008 (where only one set of surveys was conducted) it has taken place bi-annually since 1994. The latest was completed in November 2009 and is therefore extremely useful for gauging the extent to which businesses have been affected by the recession and whether or not they consider Leicester and Leicestershire to be recovering from it. Some of the findings from the survey are summarised in figures 4 and 5 (page 8).

The time series chart in figure 4 displays the 'balance of business optimism' for businesses in Leicester and Leicestershire. This indicator is arrived at by subtracting the number of businesses expecting a worse situation in the next 12 months from those expecting a better situation. A cursory glance at the chart shows that business confidence for the next 12 months has improved considerably since the very low levels seen in 2008. This growing sense of optimism is not unique to Leicestershire. A business survey commissioned by the *Institute of Chartered Accountants in England and Wales* (ICAEW) found that in Q4 of 2009 most businesses were positive about their future market place[13]. In the ICAEW survey, businesses elaborated that, having withstood the worst of the downturn, they consider themselves now well placed to take advantage of growth[13].

Another question in the Leicester and Leicestershire Business Survey asked whether or not businesses felt their market sector is growing or declining. Fourteen percent thought it was growing and 29 percent thought that it was starting to pick up. This is an improvement on the summer 2009 survey where 11 percent thought it was improving and 16 percent said it was picking up. The graphic in figure 5 (page 8) presents the responses for this question by industry sector. Businesses working in services, retail and health, education and social work were the most optimistic about the market in which they operate. Those businesses in the construction, transport and communications and manufacturing sectors were more likely to say that their sectors were stagnant or declining. That manufacturing businesses were generally less positive than other sectors suggests it is worth tempering the assumption that the next economic cycle will necessarily be characterised by a revival in manufacturing.

Also in figure 5, more specific responses around businesses' last 12 months of trading are presented by industry sector. The questions asked businesses how, over the last 12 months, their workforce, wages and prices had changed. Responses have been split according to whether each had increased, stayed the same or declined.

Of all businesses, 40 percent reported wage increases and 5 percent reported decreases; 26 percent said that they had increased their prices whilst 17 percent cited price reductions; and perhaps more importantly, only 19 percent increased their workforce whilst 32 percent said their total headcount had reduced in the last 12 months. In terms of sectors, businesses working in the construction, manufacturing, engineering and electrical industries were most likely to report a reduction in their workforce, wages and prices. Private businesses in the education, health and social work sector appear to have been affected the least by the downturn in the last 12 months. Twenty-six percent expanded their workforce whilst only 6 percent reduced their workforce. Wages grew for 75 percent of these businesses and for 47 percent, prices also increased (see figure 5).

It should be noted that in the Business Survey, those businesses which folded during the recession have not been included. If they were, we might have expected more dramatic changes to wages, prices and headcount. However, the survey remains a useful measure of business opinions and the comments about the next 12 months still hold true.

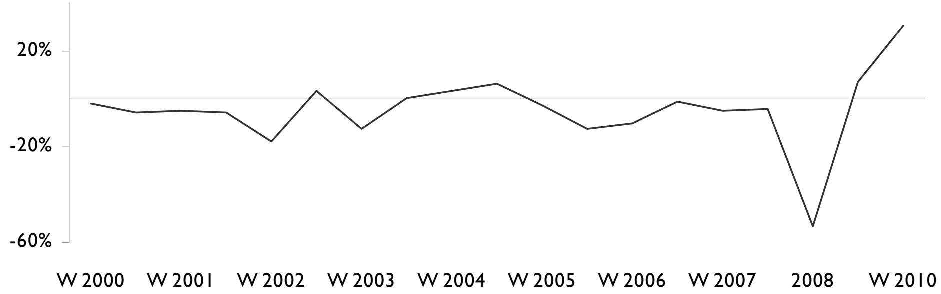
Local labour market

In figure 3 we introduced one indicator which can be used as a proxy for Leicester and Leicestershire's labour market: Jobcentre Plus-notified vacancies. The most positive recent signals (for November and December 2009) came from the transport and distributions sector. This is a sector which includes retail vacancies and it may be the case that growth in vacancies here has something to do with an increase in demand on the high-street around Christmas.

A better indicator of the overall health of Leicester and Leicestershire's labour market is the Job Seekers' Allowance (JSA) Claimant Count. There were month-on-month falls in claimant numbers in November and December, with the rate for Leicester City and Leicestershire (4.0 percent) mirroring that of the East Midlands (4.0 percent) and UK (4.1 percent). Unfortunately it is not possible to get a breakdown by the sector claimants were seeking employment in. But further positive signs can be found by the fact that, after quarterly increases in ILO unemployment since the three months up until May 2008, a reduction in numbers was recorded for September to November 2009.

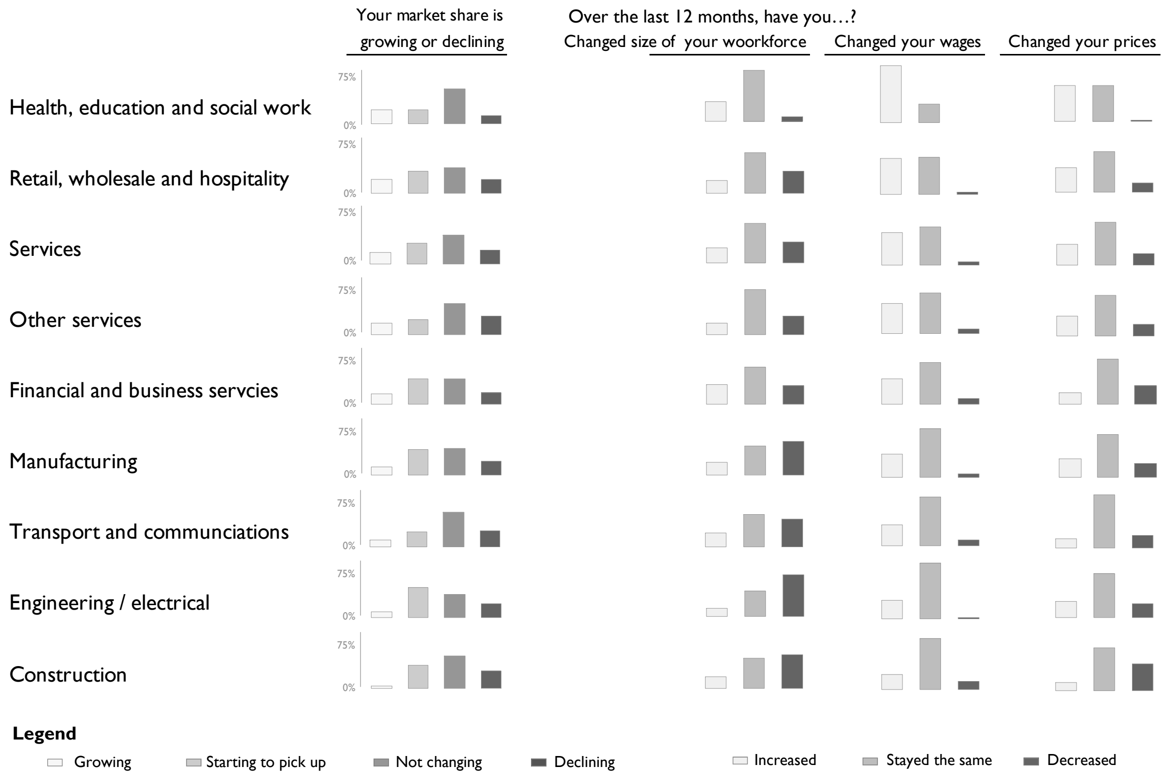
A detailed breakdown of December's claimant figures is at:
http://www.lsr-online.org/reports/unemployment_bulletin_december_2009

Figure 4 Balance of business optimism*: Confidence has continued to improve from the low levels seen in Autumn 2008 (the height of the banking crisis) and is at its highest level in fifteen years



*Calculated by subtracting the number of businesses who think their business situation will deteriorate from those who expect it to improve in the next 12 months.

Figure 5 Responses to whether businesses think their market sector is increasing or declining and how their business has changed in the last 12 months: Results are ordered by industry sector and from the most to least positive (in terms of the next 12 months).



Source: The Leicester and Leicestershire Business Survey, 2010

Conclusion

If leading economists are struggling to make concrete claims about 2010 for the UK as a whole, then it is difficult on the back of these various sources of evidence to say whether or not Leicestershire is definitely recovering from recession. Unlike the recessions of the 1970s and 1980s some comfort can be taken from the fact that manufacturing remains an important sector. There is almost a consensus amongst economists that, with a weak pound, export oriented growth driven by the manufacturing sector is the best way out of recession[10]. Unfortunately, recent signs from Leicester and Leicestershire's labour market, as well as local businesses opinions, do not yet support this view. The fact that dependence on public sector employment is by national standards small in Leicestershire (though not Leicester City) may be encouraging. So too is the fact that, more generally, a large portion of businesses in the sub-region believe conditions will improve in the next 12 months. However, with interest rate increases and tax rises likely at some point in 2010 or 2011, plus below inflation growth expected in wages, the situation for households may remain difficult. If domestic demand or spending is therefore likely to be weak for some time, then calls for a rebalancing of the UK's economic structure in favour of export oriented growth will gain greater credibility.

Note: *The views expressed in this article are not those of Leicestershire County Council.*

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