

Economics Review Issue 9

Third Quarter: August 2007

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Overview

The world powers on

The world economy continues to experience strong economic growth with its three main engines (North America, Europe and the Far East) firing well in the first half of 2007 and the outlook for the rest of the year remaining positive. There are always risks, but most of the current ones are problems of success – tight supply chains, asset price uncertainties, payments imbalances, exchange rate pressures, and a rise in protectionist rhetoric.

National growth yet to be dented by higher interest rates

The Bank of England has raised interest rates five times in the last year, from 4.5% to 5.75%, but signs that the UK economy is slowing down remain sparse. The consumer may be getting slightly less bullish and businesses are voicing fears about competitive pressures, structural change and lags in adjustment to policy changes but the economy has now enjoyed fifteen consecutive years of real growth and, barring shocks, the odds are that a sixteenth year will be added.

South West region ahead of the pack in the year to date

South West England continues to have the lowest unemployment rates in the country and surveys of output, orders and jobs have been very positive in 2007 to date. Concerns are being expressed about the strong currency, housing affordability and the availability of new and replacement skills but investment intentions are reasonably buoyant and the “mood” of South West business remains sound.

This Economics Review has been prepared by members of the South West RDA's Economics & Evidence team. The analysis is their own and does not necessarily represent the views or policies of the Agency. The Review has been compiled from sources believed to be reliable with data available up to the end of July 2007.

The Agency will accept no responsibility for errors that remain or for the results of any actions taken based on the analysis and views expressed. The document is available through the websites of the Agency and the SW Regional Observatory (Business and Economy Module).

Political Background

'Politics of change'

The international environment has shifted in the last three months with the election of President Sarkozy in France and his talk of protecting French economic interests vigorously; the growing pressure on President Bush in the United States over Iraq and climate change; tensions between Russia and Europe over energy and other matters; and the uncertain political environment in several other major raw material producing countries putting further upward pressure on commodity prices.

The most significant political change for South West England (SWE) has been at the top of the UK government. Prime Minister Gordon Brown has launched a plethora of initiatives affecting the regional business environment.

These include:

- The transformation of DTI into the Department for Business Enterprise and Regulatory Reform (BERR)
- The separation of science and innovation from BERR and the creation of the Department for Innovation, Universities and Skills (DIUS), taking higher education 'away' from schools
- The green paper on housing and related planning issues
- The plans to reform regional structures on economic development

The Regional Development Agencies (RDAs) feature strongly in a number of these areas. The detail may take several years to work through. Nevertheless, some key messages are clear:

- Eventually, there will be a Single Regional Strategy which will incorporate the current Regional Economic Strategy, the Regional Spatial Strategy and others.
- The RDAs, tasked to produce this strategy in agreement with regional partners, will have a clear focus on sustainable economic growth and business support.
- The RDAs will take on the planning functions of the Regional Assemblies.
- Local authorities will have more responsibility for economic development at a local level under the RDAs' overall commissioning of delivery.
- The whole thing will be scrutinised by a parliamentary committee for each region and guided by a regional minister – Ben Bradshaw MP for Exeter has been appointed for SWE.

Political change indeed... it is to be hoped that the current short term uncertainty from all this will emerge into some longer term stability that allows SWE to drive forward its sustainable development by unlocking its business potential. Exciting times!

World Economy

'The world powers on...'

Current Overview & Outlook

The world economy continues to experience strong economic growth with its three main engines (North America, Europe and the Far East) firing well in the first half of 2007 and the outlook for the rest of the year remaining positive.

There are always risks, but most of the current ones are the problems of success:

- tight supply chains affecting commodity prices
- asset price uncertainties in property and securities
- payments imbalances and exchange rate pressures between the main trading blocs and
- a consequent rise in protectionist rhetoric

Table WD1 shows the latest consensus forecasts on growth and inflation for the world's major trading blocs. They show a slowdown from the torrid pace of 2006, but the US slowdown this year may yet prove to be less than suggested here. Overall, the expectation is that good trading conditions will persist for South West businesses engaged in the international economy through 2008.

The OECD Economic Outlook for June 2007 broadly agrees with this consensus. It predicts real growth and inflation for its members of 2.7% and 2% respectively in 2007 and 2008. It suggests global rebalancing is underway, inflation risks are higher and that fiscal restraint should be a policy priority. It identifies the main risks to the benign world outlook as high and volatile commodity prices, a re-pricing of risk in the financial markets, ongoing payments imbalances, and housing market 'bubbles.'

During the next 18 months, payments imbalances look set to continue with the North American deficit of about US\$790 billion a year largely balanced by an Asia-Pacific surplus of about US\$550 billion. Currency and relative growth movements may alter these figures and their distribution but the general picture of substantial flows from east to west seems likely to persist. The question is whether shifts at the margin will be sufficient to affect the underlying relative growth performance of different countries.

Table WD1: Growth and inflation forecasts (% change, year-on-year)

	Growth	Inflation		Growth	Inflation
World			North America		
2006	+3.9	+2.7	2006	+3.3	+3.2
2007	+3.4	+2.5	2007	+2.1	+2.7
2008	+3.4	+2.5	2008	+2.8	+2.4
Eurozone			Asia Pacific		
2006	+2.9	+2.2	2006	+5.2	+2.0
2007	+2.7	+2.0	2007	+5.2	+1.8
2008	+2.3	+2.0	2008	+5.0	+2.1

North America

Despite some doubts about retrenchment in the housing market and rising bond yields, the weak dollar and buoyant incomes saw the US economy accelerate through the first half of 2007. The stock market made further gains and bond yields are only really rising to 'normal' levels. Recent retail sales figures suggest consumers are resilient and business confidence, displayed by the latest purchasing survey, is firm.

The policy environment remains conducive to further growth too. Low tax rates are filling the US government's coffers and interest rates are not that restrictive. Indeed, with 'a sustained moderation of inflation pressures yet to be demonstrated,' the Federal Reserve may want to raise interest rates higher than the current 5.5% before the end of the year.

There are fears that problems in the sub-prime lending market are spreading – hence stock market jitters... but a credit 'crunch' does not look imminent because the real Fed funds rate is still some way below the 'recession trigger' and risk spreads are not excessive.

Meanwhile, the Bank of Canada raised its target rate to 4.5% recently and further increases are expected. Although the Canadian economy has been relatively subdued, tight capacity constraints have built up some inflation pressures.

Europe

Recent Eurozone data has been positive, with activity rates in several major countries seemingly faster than the European Central Bank's ideas about the 'trend growth rate'. This led the ECB to increase its interest rate target to 4% in June and also to some strengthening of the euro currency. EU interest rates are still relatively accommodative, however, and should not limit expansion in the months ahead. Indeed, with inflation above target, further monetary tightening, perhaps to 4.5% by year end, seems possible.

Within Europe, not surprisingly, Germany is leading the upturn. A lot of this is export led, meaning it is potentially vulnerable to slowdowns elsewhere in the world and any overshooting of the euro on the upside. Nevertheless, there are signs of German consumers starting to increase spending which, if maintained, would underpin Europe's recovery going forward and help the world to rebalance its growth.

In France, domestic consumption has also been more positive and promises by the new government to reform the labour market and the tax system have instilled more business confidence. The EU "new entrants" are also looking quite vibrant.

Far East

China, India and their neighbours continue to experience robust economic development on the back of strong domestic and inward investment, strong export growth and some signs of higher domestic consumption as the distribution of wealth rises in absolute, if not proportionate, terms. Recent political announcements in China that the balance of growth needs to switch to domestic consumption are to be welcomed.

Nonetheless, Asian savings rates still tend to be even higher than their investment rates and this continues to fuel the flow of funds from east to west and the resulting trade imbalances. At some point, presumably when its banking system is able to cope with the resulting pressures, the Chinese currency will need to appreciate more against the US dollar.

Meanwhile, the global pressure from high demand for industrial commodities and foodstuffs is unrelenting and the oil market remains vulnerable to supply shocks. The world economy has been boosted by technological advances and labour engagement in recent years and these globalisation pressures will only continue for the foreseeable future. Against a tightening policy background, the balance between these structural positives and the potential cyclical negatives will determine the extent of any slowdown in the year ahead.

UK Economy

'National growth yet to be dented by higher interest rates'

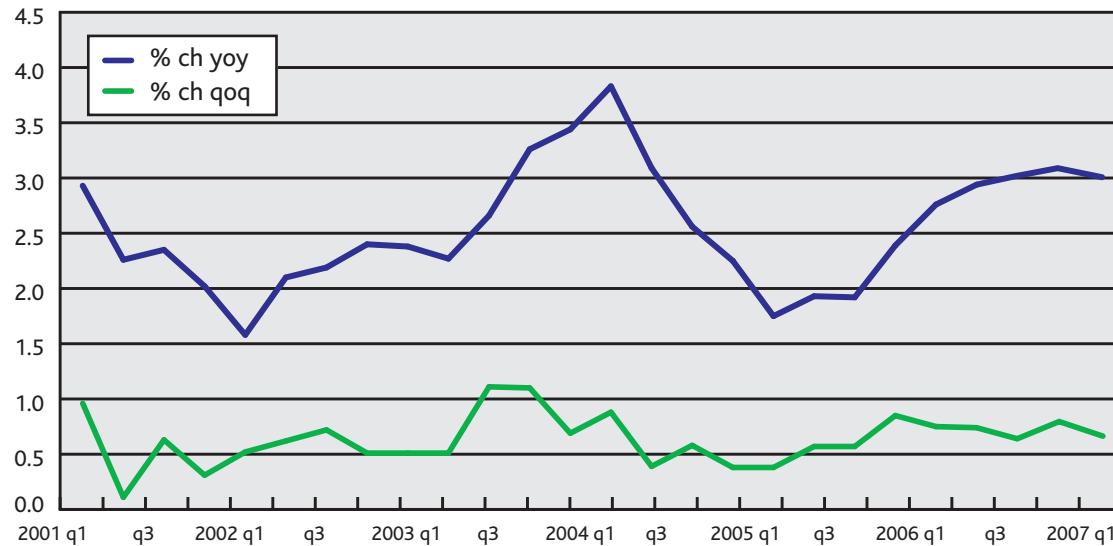
The Bank of England has raised interest rates five times in the last year, from 4.5% to 5.75%, but signs that the UK economy is slowing down remain sparse. The consumer may be getting slightly less bullish, with the pace of house price inflation easing, albeit modestly, and discretionary spending under pressure from higher interest rates and other non-discretionary costs. Businesses are voicing some fears about competitive pressures, structural change and lags in adjustment to policy changes – especially if an expected move of interest rates to 6% does materialise. Nevertheless, the economy has now enjoyed fifteen consecutive years of real growth and, whilst slower growth is expected in 2007/8, barring shocks, the odds are that a sixteenth year of growth will be added.

2007 to date - further advance

The main data for the first quarter of 2007 have been released. These data show:

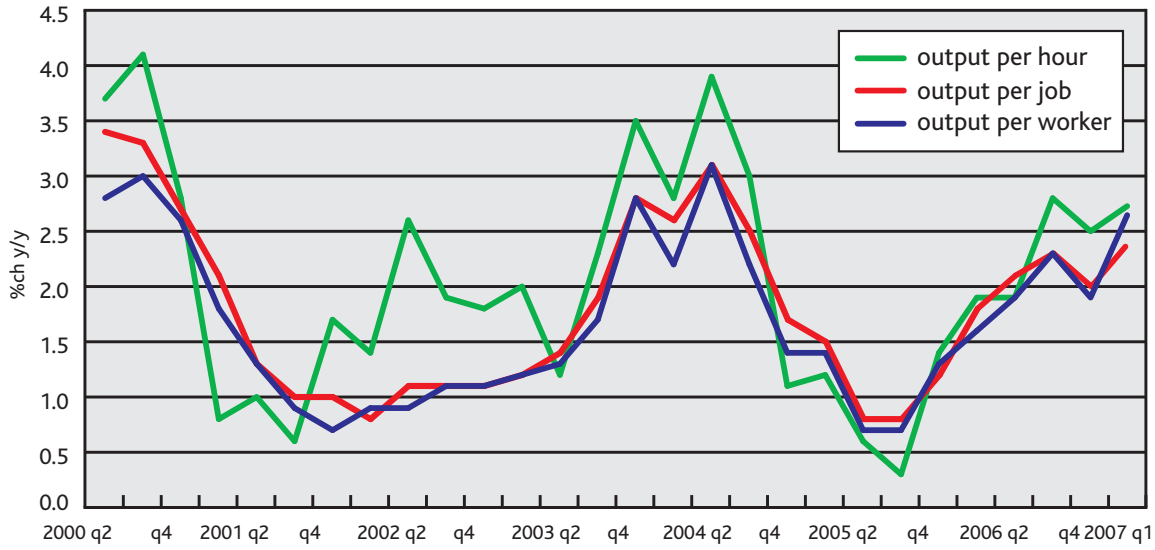
- Economic growth remained strong: real GDP increased by 0.7% quarter-on-quarter and 3.0% year-on-year (see chart UK1).
- The current account deficit was £12.2 billion, lower than the previous quarter but higher than the corresponding quarter of 2006. At 3.6% of GDP, the deficit remains high.
- Productivity continued to recover: output per worker rose by 2.7% year-on-year; output per job by 2.4% and output per hour by 2.8% (see Chart UK2). This last series is volatile around an average of about 2.1%.
- Corporate profitability remained strong with an average net rate of return of 15.1% but the gap between manufacturing (5.3%) and services (21.1%) widened (see Chart UK3).

Chart UK1: UK Real GDP growth 2001-2006, % change



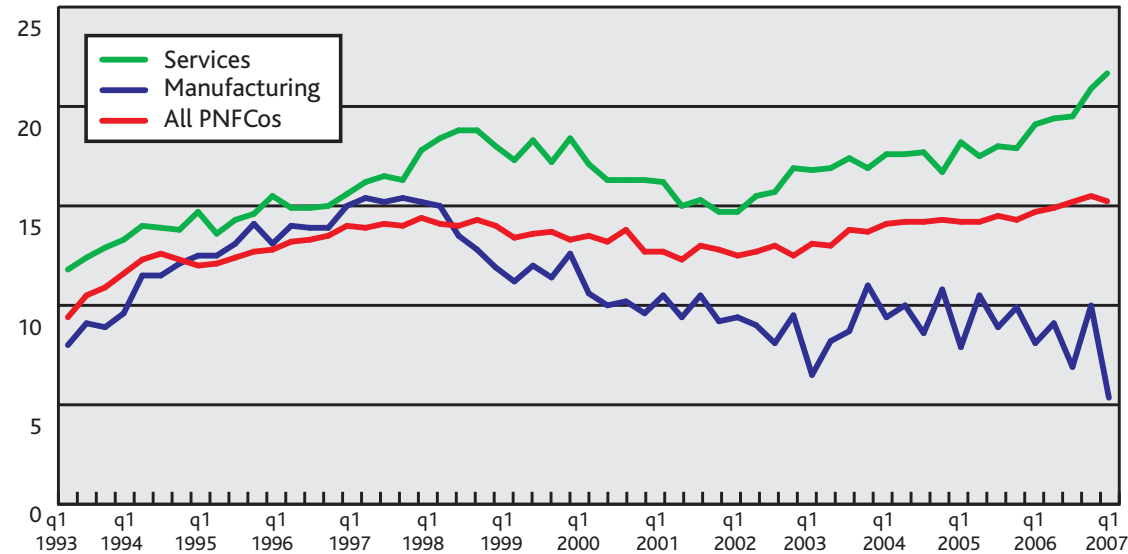
Source: ONS

Chart UK2: UK productivity: % change year-on-year



Source: ONS

Chart UK3: Corporate Profitability (net rate of return)



Source: ONS

PNFCos = Private Non-Financial Companies

The second quarter was also reasonably buoyant.

- In the three months to May, the industrial production index was 0.3% higher than the previous period with year-on-year growth accelerating to 0.6%. The equivalent services index was 3.5% higher (Chart UK4).
- Retail sales volumes growth has eased a bit but is still good (see Chart UK5). Households seem to have slowed the growth of discretionary spending in the face of higher interest rates and higher utility and other bills but savings rates have fallen too, suggesting the desire to spend remains strong.
- The first estimate of second quarter real GDP growth is 0.8%, 3.0% year on year, matching performance in the first quarter (Chart UK1).
- Input and output prices were 2.1% and 2.4% higher respectively in the year to June. Concern over a range of basic commodity prices is increasing and the recent acceleration of the input series (see Chart UK6) may be a first 'official' sign of this. Consumer prices were 2.4% higher on the same basis, moving downwards, whereas the RPI was up to 4.4%. This divergence of inflation rates shows how higher mortgage repayments are opening a gap between these two measures of inflation.

Chart UK4: Industrial production & services (% change year-on-year)

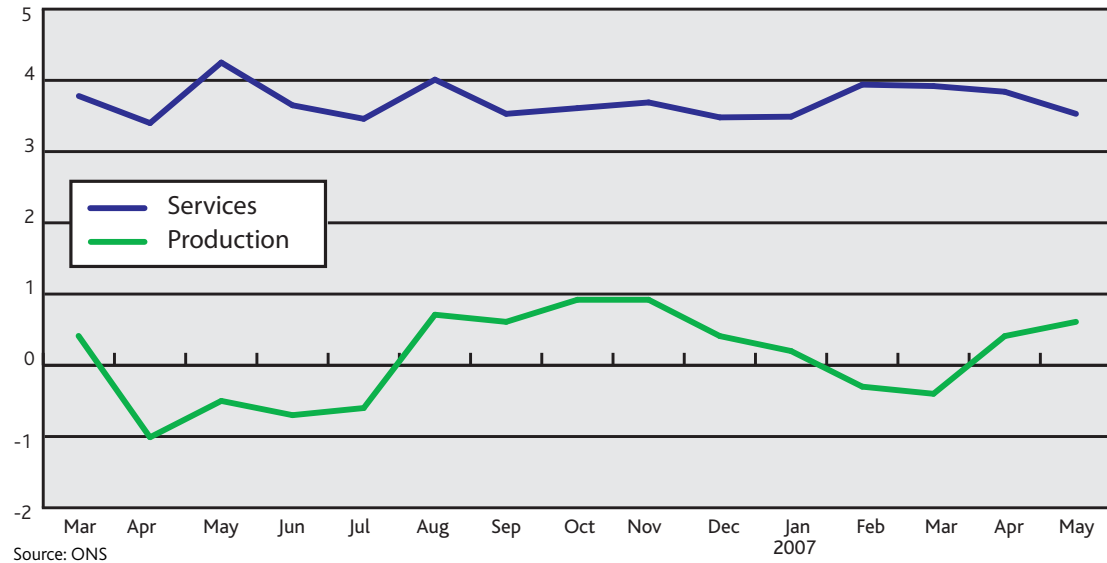


Chart UK5: Retail sales volumes (% change)

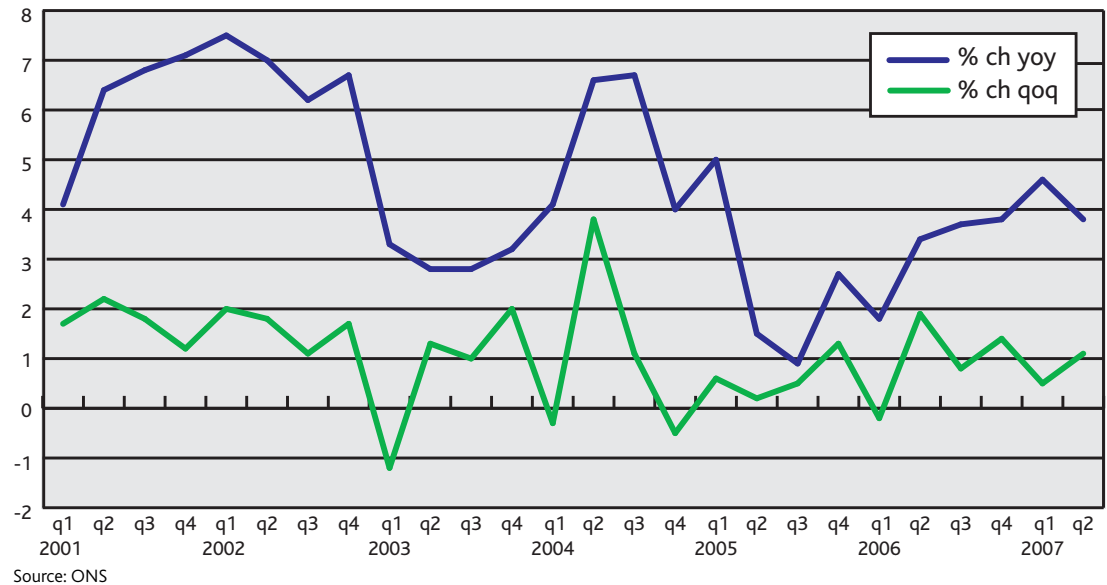
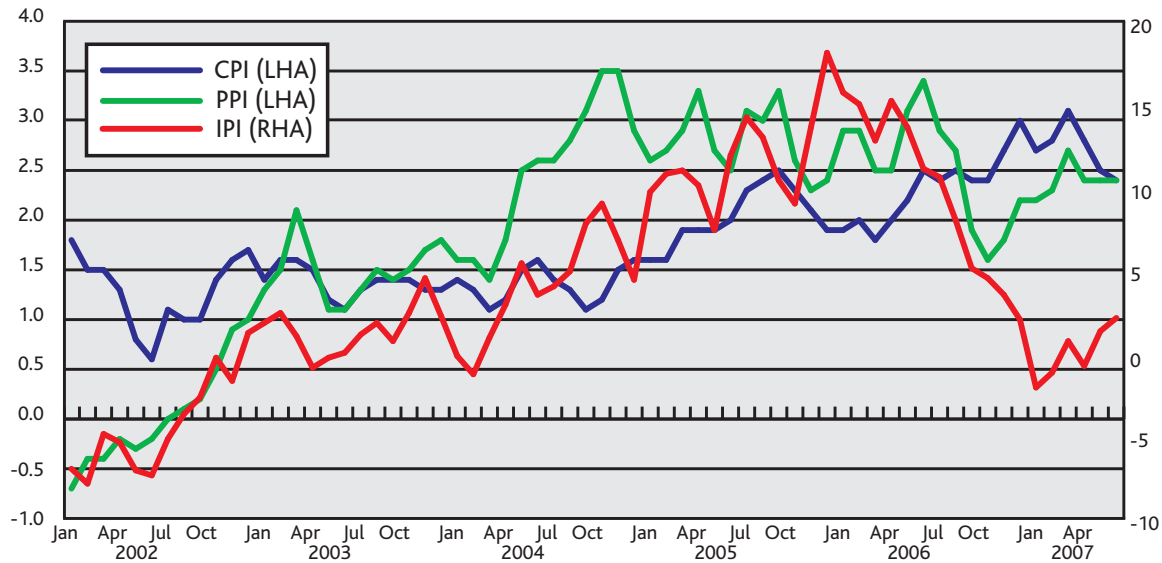


Chart UK6: Inflation (% change year-on-year)



Source: ONS

CPI = Consumer Price Index PPI = Producer Price Index IPI = Input Price Index LHA = Left Hand Axis RHA = Right Hand Axis

2007/2008 outlook

The five interest rate increases since a year ago may only now be starting to affect demand in the economy. There is some speculation that a large number of fixed rate borrowers will need to re-mortgage over the next few months and, since this will be done at largely higher interest rates, money available for other spending will be constrained.

The UK government is expected to announce a tighter spending round for 2009-2011 in its Comprehensive Spending Review this autumn. At the same time, interest rates are more likely to rise than to fall because of rapid monetary growth, tight business capacity and a risk of higher earnings settlements and other potentially inflationary factors.

Moreover, the currency is strengthening and the housing market has slackened very little to date, (although there is speculation that the introduction of HIPS will slow the market from now on). All these factors would tend to indicate some moderation of growth over the next eighteen months.

As we have seen earlier in this review, however, the global environment is still largely positive. UK investment plans seem to have strengthened and labour markets remain firm. In the March-May period, the UK unemployment rate eased a little to 5.4%.

Table UK2 shows the latest consensus forecasts for the UK economy. Since last quarter, the real GDP growth average forecast has been revised upwards significantly, with both consumption and investment moving higher. Essentially, the expected slowdown has been pushed into 2008.

Table UK2: Consensus Forecasts of UK economy

	2006	2007	2008
Real GDP	+2.8	+2.8	+2.2
Consumer spending	+1.9	+2.5	+1.9
Investment	+8.0	+6.7	+3.4
CPI	+2.3	+2.4	+2.0

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South West Economy

'South West England ahead of the pack in the year to date'

South West England (SWE) continues to have the lowest unemployment rates in the country and surveys of output, orders and jobs have been very positive in 2007 to date. Concerns are being expressed about the strong currency, housing affordability and the availability of adequate new and replacement skills but investment intentions are reasonably buoyant and the 'mood' of SWE business remains generally sound.

Regional employment

Our article on employment developments in the next section reviews some of the major announcements about job changes in recent months. Here we record that the trend in employment and unemployment rates are decreasing and increasing respectively but, over the last two years, these movements have not been significant.

Table SW1 shows the breakdown of regional employment by various factors in the first quarter of 2007. A number of interesting trends are revealed:

- Employment is growing on this 'same quarter' basis but was lower than in the final quarter of 2006
- The ratio of self-employed to total employment remains fairly constant at about 14% of the total
- The proportion of part-time working has dropped a little – as you would expect during prolonged periods of growth
- The number with more than one job is about 4-5% of the total
- Average hours worked is creeping up marginally.

Table SW1: Employment and Jobs ('000s, sa)

January-March	Total	Employees	Self-employed	Hours
2005	2458	2068	362	30.4
2006	2456	2104	336	31.0
2007	2471	2108	348	31.1
	Full time	Part-time	Temporary	2nd jobs
2005	1721	736	102	109
2006	1747	708	115	95
2007	1755	715	123	116

Source: ONS

Table SW2: Employee jobs by industry ('000, not sa)

	Agriculture, F&F	Utilities	Manufacturing
March 2004	26	16	263
March 2005	29	15	254
March 2006	27	14	249
March 2007	29	15	247
	Construction	Private services	Public services
March 2004	93	1052	683
March 2005	103	1060	703
March 2006	106	1073	720
March 2007	96	1089	721

Source: ONS

Table SW2 offers the jobs breakdown by broad industry category in March 2007 in comparison with the same month of previous years. It shows the declining role of manufacturing as a jobs creator (16,000 jobs lost in the last three years) and its substitution with private and public sector jobs (75,000 added).

Regional outlook

Recent surveys and anecdotal evidence suggest SWE businesses are continuing to prosper in the current positive economy.

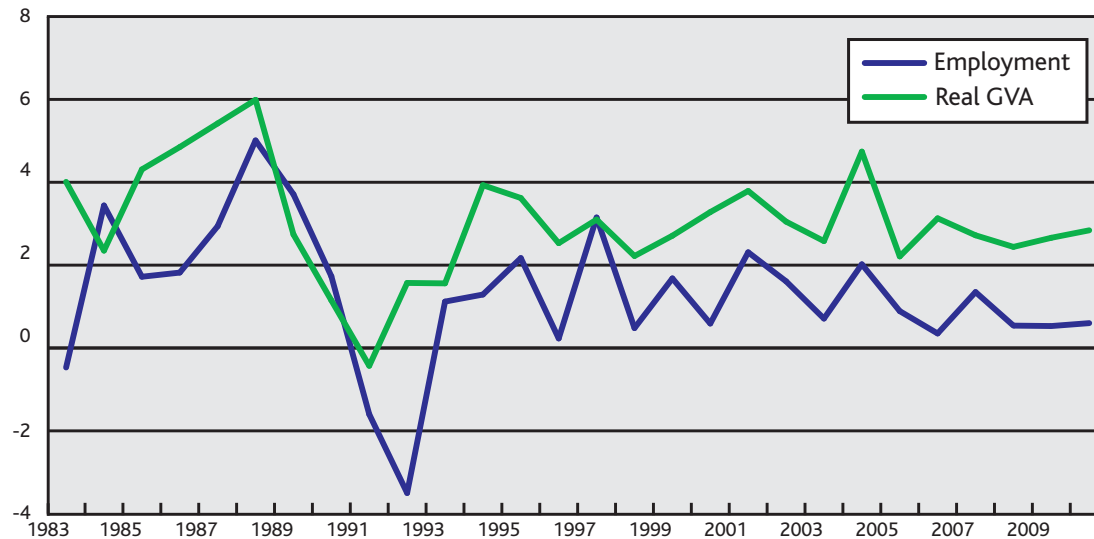
In terms of private business conditions, the Royal Bank of Scotland says SWE "remained top-performing UK region in June", with job creation at a new survey high. New orders continue to flow in at a high rate and the backlog is lower, suggesting strong current output growth. This also appears to be giving SWE firms more pricing power.

The Bank of England Agents' summary of business conditions in July reported that consumption was firm, but with a little slowdown in discretionary and housing spending. Investment and employment intentions, however, were described as 'robust' and 'elevated' respectively. Capacity pressures persist and profit margins are being rebuilt.

July's CBI Quarterly Industrial Trends Survey said business confidence had flattened out at April's high level. Some new orders growth has moderated but investment intentions remain firm.

Given this positive mood, we are confident that 2007 will be another good year for the region. In the months ahead, however, the tightening of discretionary spending may become more apparent. Slower growth seems likely for 2008, although the risks of something worse than that are still modest.

Chart SW1: SWE growth outcomes & forecasts (% change year-on-year)



Source: Experian Regional Planning Service

Chart SW1 shows Experian's latest growth forecasts for SWE in terms of output (GVA) and employment in the context of the historical trend. It records some moderation of growth in line with national and other expectations in 2008 but a re-acceleration thereafter: no sign of recession on this view! In broad terms, Experian expect the Greater South East to prosper more than other regions in the years ahead as the 'natural' advantages of the former in terms of agglomeration, structure and momentum re-assert themselves. If this is true, the easterly parts of SWE will probably 'benefit' from both 'pull and push' factors more than the rest of the region.

Given current investment plans, however, we are more sanguine about parts of the far peninsula and would be a little more concerned about what has been a relatively 'soft centre' – parts of Dorset, Somerset and Devon.

In the years ahead, given SWE's virtual 'full employment' and desire for sustainable growth in living standards and wider well being, there should be a drive to shift the balance of SWE growth from employment-led to productivity-led. To do this, SWE businesses and public investors need to focus on getting productivity growth, in terms of output per worker or per hour, to average at least 2% per annum and preferably higher.

This needs to be accompanied by higher resource productivity: producing growth of incomes whilst reducing material and energy inputs. These labour and resource productivity goals will be difficult to achieve but are not unrealistic and are worthy aspirations.

Nigel F Jump, Chief Economist, August 2007

The Export Performance of South West Companies

This report summarises the key findings of new research into export performance by SW businesses commissioned by the Agency under its internal Corporate Research Programme.¹

Why international trade matters - the link between trade and productivity

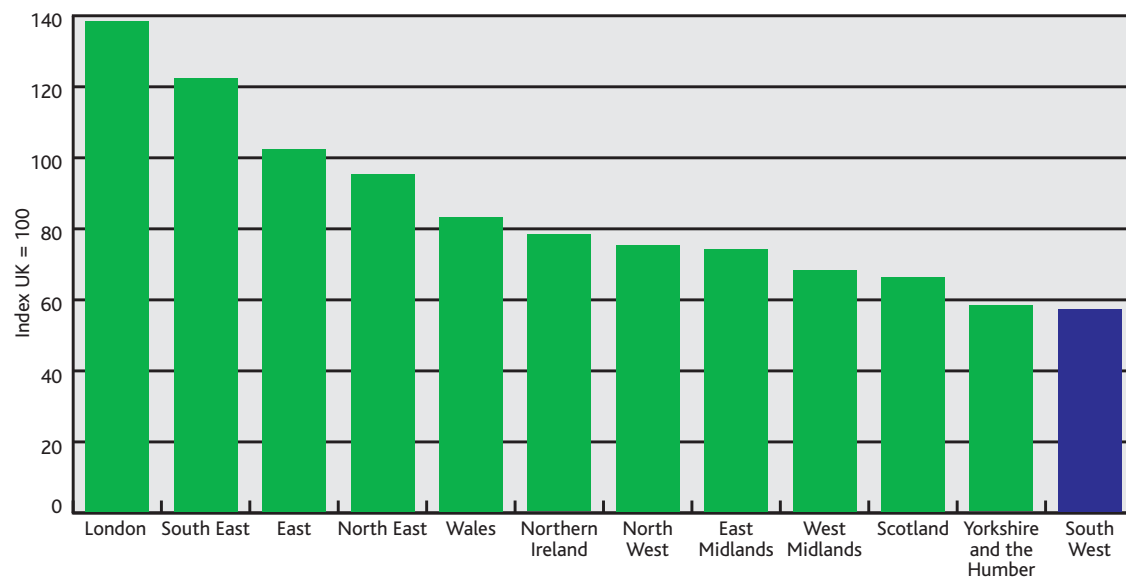
International trade (including export activity) is a key dimension of competitive performance in an increasingly global economy. At an aggregate level, exports pay for imports and trade, in any direction, brings the benefits that flow from participation in the international division of labour and economic activity. Businesses that export tend to have higher levels of productivity and productivity growth. They invest more in R&D and are more innovative whilst exposure to overseas markets, both through competition and collaboration, brings benefits from international learning and knowledge transfer. More competitive, export businesses can also challenge and stimulate domestic firms in local markets. The scale and growth of export activity matters because it impacts economic performance at a regional and sub-regional level.

Previous research has pointed to a strong relationship between productivity and exports at the level of the individual business. One study found that productivity among exporting firms was nearly 17% higher amongst firms that were exporting, having taken other factors into account. More productive businesses are more likely to export and businesses that start exporting are more likely to experience a productivity boost, particularly early on. This suggests that higher levels of productivity provide the resources needed to overcome any barriers to exporting, together with the ability to compete effectively in overseas markets. It also highlights the benefits of exporting in terms of access to wider markets and the stimulus provided to innovation, learning and knowledge transfer.

¹ The Export Performance of Businesses in the South West of England in Comparative Perspective: Professor Martin Boddy et al, University of the West of England (UWE), (for the South West RDA and UKT&I): June 2007

The South West's Export Performance

Chart EX1: Index of goods exports and a proportion of goods GVA, (2004)



The various measures of export performance point to the relatively poor performance of South West England (SWE) as a whole compared to the national picture. Export of goods in 2006 accounted for only 13% of total output by value in SWE compared with 23% nationally. On this, and most other measures, SWE has lagged behind all the other regions and countries of the United Kingdom over the last 10 years.

Measuring export activity is not straight-forward: data on service exports is weak at a national level and incomplete at a regional level. Moreover, goods exports record the final value rather than value added. There are other issues to do with head office effects on export records and supply chain issues: "we may not export but we supply exporters". However, these issues often apply to other regions and may not significantly alter the picture shown (Chart EX1) – in which SWE has the lowest propensity to export of all the UK regions.

Table EX1: Manufacturing as a percentage of total output, (2004)

East Midlands	North East	Wales	North West	West Midlands	Yorkshire and the Humber	Northern Ireland	Scotland	South West	UK	East	South East	London
21.1	19.1	18.4	18.4	18.4	17.9	16.2	14.8	14.4	12.7	11.2	7.5	

Services are much less likely to be exported than goods, so regions where goods output accounts for a relatively large or small proportion of total output (as Table EX1 shows) might be expected to have a correspondingly high or low overall export propensity. Looking at goods alone (Chart EX1), the regions making up the 'Greater South East' whose overall export propensities might be expected to be depressed by the relatively small contribution of manufacturing to their total output, come out with the highest 'goods only' export propensities. SWE, however, has the lowest propensity to export its goods of all the UK regions.

In summary, the link between engagement in international trade and productivity indicates a clear need to understand the region's relatively weak export performance.

Research findings

The new study drew on a combination of the existing evidence base, aggregate data from HM Revenue and Customs and statistical analysis of firm-level data based on merging information from the Community Innovation Survey (CIS) and ONS data on individual businesses (the ARD). This provides the basis for understanding the various factors that can account for differences in export performance by SW businesses and the possible implications of these in policy terms.

One explanation for the region's poor performance might have been its industrial structure – it might have fewer businesses in those sectors with generally higher levels of export activity. This proved not to be the case.

If SWE had the same industrial structure as the South East, the best performing region in terms of exports, the value of regional exports would actually fall by over 20%. Industrial structure does not account for the 'export gap' in SWE.

In fact, it is the lower propensity of SW businesses, at firm level, to export compared with those in equivalent sectors in the South East and elsewhere that largely accounts for the export gap. If SWE businesses had the same propensity to export, by sector, as those in the South East then exports would be over three times greater by value. This suggests a need to identify those specific firm level factors that account for the export gap.

Information on exports of services is more limited than that available for goods. Based on the available information, SWE performs very slightly better compared with other regions in terms of services than it does on goods. Service exports as a proportion of services turnover are still, however, only 60% of the national average. The comparatively small share of total exports accounted for by services indicates that the region has also lost out, in relative terms, on the recent expansion of service-based exports seen nationally since the early 1990s.

Tourism expenditure is particularly important to SWE services economy and is not captured by regional statistics on exports. Overseas tourism (i.e. foreign visitors to the region), however, accounts for a much smaller share of overall expenditure in SWE, 17% of the total compared with 36% nationally on one estimate. This would imply that the exclusion of tourism from service export data does not help to explain the regional export gap, if anything it contributes to that gap.

Analysis of the combined ARD/CIS data shows that:

- Taking London as the benchmark, and taking into account industrial structure, the 'odds' of a firm exporting compared to those in London are shown in Table EX2 with equivalent SWE businesses being about half as likely as the benchmark, broadly in line with other non-Greater South East areas.

Table EX2: Exports odds after industrial structure

London (benchmark)	South East	East	North West	Yorkshire and the Humber	West Midlands	North East	East Midlands	South West	Wales
1.00	0.84*	0.76*	0.67	0.60	0.56	0.55	0.54	0.52	0.49

*Difference not statistically significant

The study also found:

- There is a strong association between exporting and the size of firm expressed in terms of capital stock
- There is a small but statistically significant association between the proportion of a firm's workforce with a degree and the likelihood of exporting
- The odds of an American-owned firm exporting are 1.5 times that of a UK-owned firm
- The odds of a European-owned firm exporting are 1.3 times that of a UK-owned firm
- The odds of an 'other foreign-owned' firm are 1.2 times that of a UK-owned firm
- The odds of a firm that has undertaken process or product innovation within the previous three years exporting are 1.8 times greater than one that has not
- The odds of a firm with an external website exporting are 1.3 times greater than for one without
- The odds of an older, pre-millennium, firm exporting are 1.7 greater than for a younger firm.

Table EX3: Exports odds after industrial structure, capital stock, degrees, ownership, innovation, website and firm age

East	London	South East	North West	Yorkshire and the Humber	East Midlands	Wales	North East	South West	West Midlands
1.14*	1.00*	0.94*	0.89*	0.85*	0.84*	0.80*	0.77*	0.75*	0.71

*Difference not statistically significant

After including the full set of variables described above, all but one of the regional differences (measured against London as the benchmark) are reduced to a statistically insignificant level (Table EX3). That is, the remaining differences observed may be due to sample variation rather than actual differences in export propensity.

Finally, although the evidence is limited, the study found considerable differences within SWE between more economically buoyant parts of the region. The analysis looked separately at the West of England (Bristol City – region), and the rest of the region.

Policy implications

The new study provides a range of findings that might inform future strategy in relation to exports. It is clear that SWE's export gap relative to leading regions of the United Kingdom is very considerable. There is also, now, a relatively strong and growing evidence base as to the factors associated with export activity. It is less evident that there are very immediate policy levers, particularly at a regional scale, that can be pulled to effect positive change. It is possible, however, to pull out a number of policy pointers from the analysis.

- There is a strong association between productivity, innovation and exports. The causality, however, is not clear. It is very likely to run all ways between these three factors – and thus to an extent defies statistical analysis. It does imply, however, that regional economic strategy should not focus on exports in isolation. It needs to address the issue of exports, productivity and innovation simultaneously and should aim to capture positive feedback between the three.
- Support for innovation needs to be broadly defined to include not only R&D, product and process innovation but a broader range of 'soft' factors that may predispose firms to export. These include organizational learning, information flows and networking – 'absorptive capacity' in all its dimensions.
- Linked to this, the demonstrable association between graduate employment and exports, and the known relationship between higher levels skills, innovation and productivity growth only reinforce the importance of facilitating the supply and retention of graduate skills at a regional level.

- The effects of ownership on propensity to export are striking. Any additional FDI could be a significant boost in this respect. The limited supply of such investment and lack of effective leverage is, however, well understood. Given that foreign-owned businesses are known to be more active in export markets, it might be explored whether it is possible to build on this activity, in some way, within the region and to somehow piggy-back more effectively on this activity through supply chains. It is likely that existing industry-clusters already pursue this goal to some extent.
- Evidence on the benefits of product differentiation suggests that a focus on narrowly defined target sectors may be no more appropriate than a broadly-based approach to export promotion, innovation support and strategies to boost productivity. Evidence on the positive effects of agglomeration on exports, on the other hand, suggests it might be worth attempting to identify and to focus on export 'hot-spots' within the region. There is always going to be tension between spreading effort too thin and being too focussed and 'missing winners'. An element of experienced judgement will remain important.
- Evidence that larger and more established firms are more likely to start exporting might suggest that such firms should receive greater priority. There is a tendency, rooted in the 'enterprise culture' to focus on smaller and newer firms which, the evidence suggests, face particularly strong barriers to export entry.

Conclusion

This study represents a step forward in our understanding of SWE's relatively poor export performance. It is clearly demonstrated that the export gap cannot be explained (or even excused) by the region's sector mix or the omission of tourism from the regional exports data. This points to the explanation being at the level of the firm and, thereby, the relative levels of capital stock, foreign ownership, graduates, innovation and web engagement. Adjusting for these factors reduces the inter-regional export differences to below statistical significance. We do not need to look for other factors.

Nevertheless, we need to understand why SWE businesses score relatively lowly on these factors – for example, a particular SWE weak appetite for exporting. Business aspiration, or the lack of it, may well lie at the heart of the matter. Anecdotally, it is often mentioned as the underlying constraint on SWE engagement in trade and is probably an area worthy of further attention by policy makers and deliverers.

Donald Barr, Evidence Adviser

Regional Statisticians in South West England

What are Regional Statisticians?

Following Professor Christopher Allsopp's review of statistics for economic policy making, (originally commissioned by HM Treasury), the Office for National Statistics (ONS), with RDA financial and other support, has established teams of Regional Statisticians in the nine regions of England. These teams began to operate in April 2007.

The brief for the regional statisticians is ambitious, especially considering that each regional 'team' is only two members strong. (Indeed, in South West England (SWE) only one statistician is in post as yet.) Nevertheless, an important step in the right direction has been taken, providing a direct link between the ONS and regional users of statistics.

What will Regional Statisticians do?

Essentially, Regional Statisticians are the link between the ONS and regional partners including the RDAs, Regional Assemblies, Observatories, Government Offices, Local Authorities and private organisations.

The core functions of Regional Statisticians are to:

- work with regional partners on collaborative projects
- gather intelligence to help improve the quality of ONS data
- quality assure regional GVA data
- improve the quality of Inter Departmental Business Register (IDBR) and business survey data
- advise ONS' decision-making by feeding regional views to the centre

- provide access to IDBR data for RDAs and assist with the problems of suppliers of IDBR data
- advise ONS of problems of use and interpretation of data
- facilitate the provision of training
- assess locally commissioned or held data

To date, the Regional Statistician for SWE has been busy meeting regional partners, learning about their roles and publications, and using this insight to start putting these functions into practice.

The localised collaborative projects shown at the top of the core functions listed above are particularly exciting. These were developed in conjunction with an Advisory Group consisting of representation from key regional players and will account for up to 30% of the Regional Statisticians' time. Examples of some of the projects that will take place this year include:

– Exploring the possibilities of getting better evidence regarding productivity drivers

It will be attempted to secure better evidence about productivity drivers for the next SW Regional Economic Strategy (RES). The Regional Statisticians will explore whether other sources are available and influence data holders to release data at a finer geographic breakdown where appropriate. More information to measure innovation and investment would be particularly useful.

– Using the Inter Departmental Business Register (IDBR) to improve Evaluation of RDA programmes

The South West RDA invests in a number of projects through direct investment in business, investment in areas, and sometimes through arms length organisations. It is important for the Agency to understand the impact on businesses that have been supported, either directly or indirectly. The Regional Statisticians' access to the ONS' IDBR, should allow for improved evaluation of programmes.

– Spatial analysis of business growth

Improved access to IDBR data on business employment, turnover, age and ownership could be used to inform and evaluate the effectiveness of investment activity in a number of defined geographical areas.

– Monitoring priority sectors

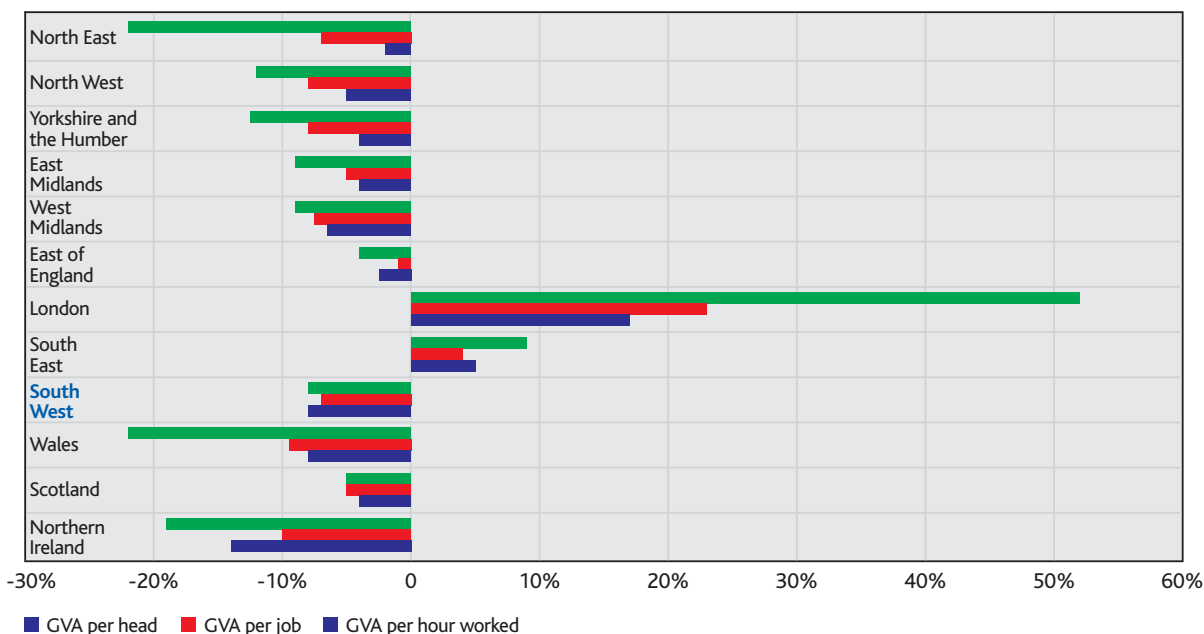
The RDA has identified a number of priority sectors on the basis of size, potential and/or regional comparative advantage and, importantly, the suitability/opportunity for successful public intervention. Currently, these are monitored on a regular basis, mainly in terms of economic output, employment and productivity. The tracking of sector performance will provide an indication of whether the priority sector approach has been relatively effective, as well as providing key information on important parts of the region's economy.

Will Regional Statisticians have an impact?

Users of regional statistics have in reality gained much more than just two statisticians. The Regional Statisticians from each of the nine regions work together as a team to help improve Regional Statistics all over the country. For example, a group of them recently met up to discuss how best to help local authorities in the quality assurance process of results from the ONS' Annual Business Inquiry (ABI). Similarly, other areas such as 'women in enterprise' are of huge interest nationally, so a co-ordinated approach to research in this area is one way forward.

The Regional Statisticians also benefit from being part of the Regional Economic and Allsopp Division (REAAD) of the ONS. This Division has expertise in championing, analysing, and presenting data, from a regional perspective.

Chart RS1 Representing Regional GVA (2005)



For example, an interesting piece of work is nearing completion within the REAAD, looking at different ways of presenting GVA, at a sub-regional level. To give you a flavour, consider Chart RS1 below:

The much (over) used measure of GVA per head shows London to have been over 50% above the UK average in 2005. The SWE was about 7% below the UK average. When GVA per job is considered, the London advantage is halved. The relative position of SWE, in contrast, changes little. This mostly reflects the large number of commuters from outside its boundaries affecting activity in London. When GVA per hour worked is considered, the London lead comes down again, whilst the SWE remains relatively unchanged.

Analysis of the factors that contribute to these movements shows that regional differences in activity and commuting rates are major determinants of the differences in these productivity indices, reflecting the workplace and residence factors in the statistics. There are other factors including hours per job and employment rates. For SWE, the hours per job, employment rate and activity rate factors would all tend to push up the region's relative measure above the national average. The 'other factors', related to the region's industry mix and productivity 'gap' – relatively low skills, capital investment and market access, almost completely offset these, however, explaining why the three measures for this region are so close together. Commuting is said to have no impact at all. Given the significant flows in and out of the Bristol, Swindon and Bournemouth/Poole areas, this must be either that gross flows net out to be relatively insignificant or there is an element of under-recording (by assumption) of SWE commuting flows.

In the next issue of this 'Economics Review', we may return to these different ways of looking at productivity at a sub-regional level. In particular, we hope to show what contributes to the variability in different productivity measures.

Meanwhile, if any readers would like to find out more about any aspects of the Regional Statisticians work please contact me directly.

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SWE Regional Employment Developments

Chart EM1 shows the latest Office for National Statistics (ONS) unemployment rates across South West England (SWE). While SWE has the lowest regional unemployment rate, overall, there is considerable variation across the region. What is most striking about the chart, however, is the change between the latest figures (October 2005 to September 2006), and for the same period 12 months previously (2004/05). Is this credible?

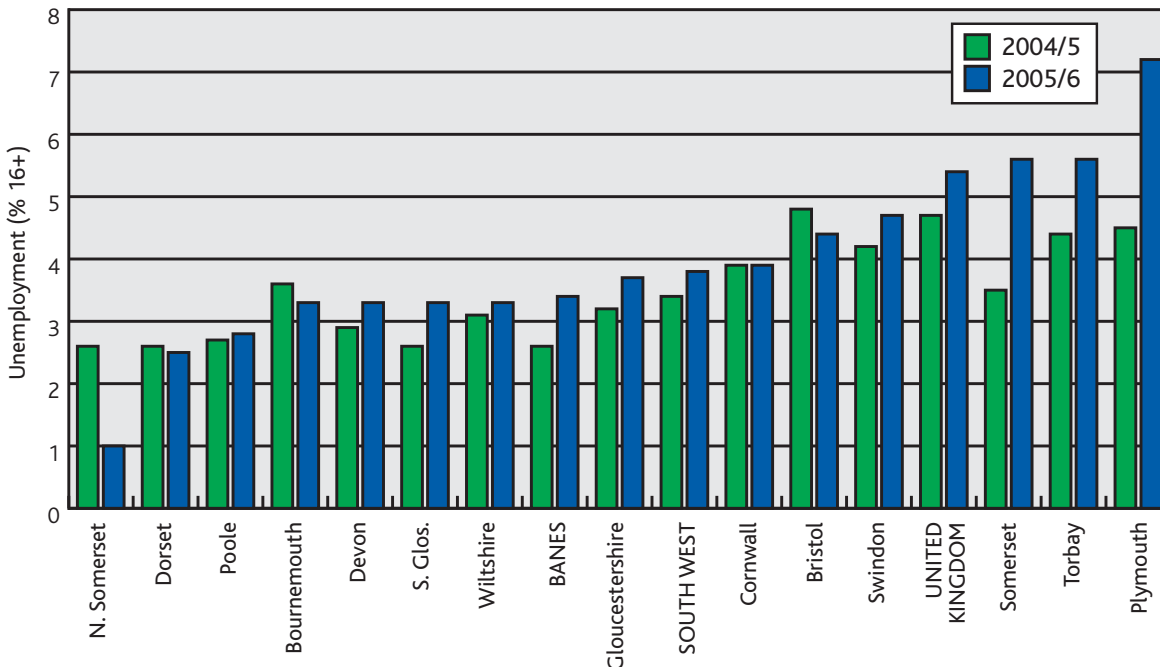
According to the latest figures, three parts of SWE have unemployment rates that are higher than the UK average – Somerset, Torbay and Plymouth. However, 12 months previously, only Bristol exceeded the UK average. Also, some areas have seen large swings in unemployment – notably, Plymouth (up by 2.7%), Somerset (up by 2.1%) and North Somerset, which has quite remarkably dropped from 2.6% to only 1%!

A similar chart for employment would show substantial and remarkable swings in relative rankings - with Bath and NE Somerset dropping eight places (from 3rd highest), North Somerset rising five places from 7th to 2nd highest; and Devon rising from 10th to 6th.

What is going on in our local labour markets? Are we really seeing such massive shifts from employment to unemployment and vice versa? Despite the more weight given by the press to the 'bad news' stories regarding job losses, the answer is... probably not. Unfortunately, at least from the analyst's point of view, much of the explanation appears to lie in the ONS' decision to reduce the local authority sample sizes used in the Annual Population Survey, from which the above labour market statistics are derived. Reduction in sample sizes has substantially reduced the robustness of the data - making it very difficult to detect changes in the labour market that are real and important on the ground.

Briefly, as a result of reducing the sample sizes, the confidence intervals that allow the (data) user to assess the robustness of the statistics have increased for most parts of the region, particularly for the counties (as opposed to the more urban unitary authorities), and have as much as doubled in some areas. For example, Somerset's unemployment rate has increased from 3.5% in 2004/05 to 5.6% a year later – however, the confidence interval has also increased from +/- 0.8% to +/- 1.6%. The two confidence intervals overlap – 2.7% to 4.3% and 3.8% to 7.2%, making it difficult - impossible even - to say whether we should be concerned about rising unemployment in this area or not.

Chart EM1: Sub-regional unemployment rates 2004/05 vs. 2005/06



Source: ONS

Furthermore the reduction in sampling for this data is catastrophic for analysis of employment data at lower levels, particularly for rural districts where sample sizes have been most affected. Hopefully, the ONS will find the funds soon to reinstate the sample boosts that made this one of the most useful datasets to those interested in regional and sub-regional economics.

In the meantime, we will be even more reliant on other, 'local' information on the labour market, such as reports in the media and on the internet. The remainder of this piece outlines some of the key job gains and losses to the region reported over the last few months. There has been a little more positive/less negative balance of jobs news over the last six months.

Finance

Substantial moves are afoot in the banking sector. In May, Barclays announced that it was to cut 1,000 jobs from its centre in Poole over the next three years. The bank hopes to drive efficiency gains in this highly competitive, global sector, through increasing automation of its processing systems. Meanwhile, some of these job losses could be offset by the opening and future expansion of the Bank of New York, also in Poole. While many of the current jobs come from its recent acquisition of JP Morgan's corporate trust business, the bank plans to increase its workforce from 170 to 300 by 2008, with a possible 200 more jobs to follow pending 'growth, space and infrastructure'. Elsewhere in finance, Fresh Start Home Loans is to shed up to 55 of the 250 jobs at its finance business in Falmouth.

Marine

DML's Appledore Shipyard received a welcome jobs boost. Appledore is to recruit 200 more skilled workers – including 100 permanent positions – following the company's success in securing the design and build of a new super yacht. Meanwhile, whilst the future of the Devonport Naval Base in Plymouth appears to be secured, the detail has yet to be revealed. Defence Minister Des Browne's recent announcement of orders for two new aircraft carriers was said to be '...good news for the three communities' (i.e. Plymouth, Portsmouth and Faslane naval bases), but there have also been warnings that there would still be 'some reductions' in the 17,800 personnel currently employed at the bases and Plymouth may yet lose out in relative terms.

Retail & distribution

Business confidence in Exeter is at an all-time high, according to the latest survey of members by the city's Chamber of Commerce, with Exeter firms amongst the most optimistic in the country concerning further recruitment plans this summer. A third of members expect their staff numbers to increase during the next quarter, with the new development of the city centre Princesshay site boosting the city's ability to create new jobs. Debenhams, the 'flagship' store of the new development, intends to add 150 new employees to its 170-strong staff when the store moves into its new larger premises in September. However, detrimental effects have been seen elsewhere in the city's shopping centre – Foodeaze, a 'carbon neutral food market', which used locally sourced produce and transit vehicles running on bio-diesel folded only months after opening, with the loss of 60 jobs. While the retail side of the business was growing, the restaurant and bar section could not compete with the new Princesshay site.

Elsewhere in Exeter, EDF Energy is to expand into a second site in the town with the creation of about 300 jobs, while ClientLogic is to shed up to 140 jobs, having lost a contract to provide customer services for John Lewis Direct. In other call centres, up to 40 jobs are to be created in Truro as demand takes off for BT Vision, BT's next generation digital TV service. Truro is one of only two UK call centres selected to manage thousands of daily customer enquiries. This will take the headcount to 240, making it one of the biggest BT sales centres in the UK.

Up to 100 new jobs are to be created in Avonmouth by Constellation Europe, with the construction of a massive bottling plant. The aim is to cut shipping costs by 40% and reduce the mountain of imported green glass produced by British wine drinkers. ProLogis are developing Crossflow, a 550,000 sq ft distribution centre, also in Avonmouth, which will create 600 new jobs after opening in March 2008. Meanwhile, Wincanton Logistics announced closure of their Tewkesbury distribution depot, with the loss of 150 jobs. The decision to close the site, which serves Somerfield, followed a strategic review of the supermarket's supply chain.

Manufacturing

In Food and Drink, British Bakeries, which makes bread products for Hovis, is to close all manufacturing and support services at its factory in Plymouth, with the loss of up to 150 jobs. Dairy Crest is to close its dairy in Totnes, Devon, with the loss of up to 164 jobs, in order to transfer production to Gloucestershire and East London. Faccenda is to close its chicken processing factory in North Dorset, with the loss of about 120 jobs.

Cosmetics firm Swallowfield is to shift up to 150 temporary posts to new low-wage factory in the Czech Republic – the firm says that the 500 full-time jobs in Wellington and Bideford are not at risk. West Pharmaceutical Services is to shed up to 90 of the 480 jobs at its four sites in Cornwall by the end of the year, following the loss of a contract at its St Austell factory.

Airbus is to cut 1,100 jobs at its site in Filton, Bristol over the next three years, as part of a plan to shed 10,000 jobs across Europe. France and Germany were set to take the brunt of the losses, but concerns have been raised recently in the press that the new French presidency may want to renegotiate the distribution of the proposed level of (UK) job losses.

Ash & Lacy is to close its perforated metal products factory in Hayle, Cornwall, in September with the loss of up to 84 jobs, in order to focus manufacturing in the West Midlands. Precision engineering firm Hymec Industries has set up a new manufacturing base in Mauritius after being unable to find a suitable industrial site for a new factory in Teignbridge. This means that 100 skilled jobs that could have been created in Devon have gone abroad.

Remploy, the country's leading provider of employment services for disabled people, announced plans to quadruple the number of people it helps into work over the next five years. However, this programme involves a major transfer of resources from loss-making factories, and manufacturing is to cease at SWE plants in Lydney, Poole, Plymouth and Redruth, which together employ around 160 people. According to Remploy, no disabled employee will be made compulsorily redundant and support will be available to those who wish to remain in work.

There have been announcements of expansions to offset these losses. Sunseeker International is planning to create 500 new jobs at the Legend Yacht boat building facility at Osprey Quay in Portland, following acquisition of the manufacturing facilities vacated by Luhrs Marine. Sunseeker is the world's largest privately-owned builder of motor yachts, employing 1,800 staff. Sifam Fibre Optics is creating 20 new jobs at its telecoms components factory in Torquay, having won a number of new contracts. Corins is to create 38 manufacturing jobs in Cirencester, having won approval to sell its new hip resurfacing joint in the United States. Continental Underfloor Heating is planning to set up a new £3 million 13,000 sq ft headquarters in Bude over the next two years, with the creation of 50 jobs.

Others

Bath Press is to close its printing operations in Bath and Glasgow with the loss of 246 jobs (around 200 in Bath), though 20% of the workforce will be offered employment at other parts of the CPI group. This follows losses of £20 million since 2002, with declining sales in the face of a competitive market. The Department for Work & Pensions is to close its Kingsmead House pensions office also in Bath, in March 2008, with the loss of 370 jobs.

However, to end on a positive note, the SWE skills base is expanding. The Peninsula Medical School, a partnership between Exeter and Plymouth Universities, saw graduation recently of its first 88 doctors. It is believed that 67 will stay in SWE to practise at Devon and Cornwall's main hospitals. Also, the Combined Universities of Cornwall – which says it was "created to be the economic catalyst for the regeneration of the Cornish economy" – held its first graduation ceremony this summer, with 207 students graduating in biology, english, geology, geography, mining engineering and renewable energy. With Agency support, the university has expanded substantially since its inception, with more than 450 new students beginning their studies this October.

This means both jobs and a foundation of high quality skills for the county and the wider regional workforce.

Allison McCaig, Evidence Adviser

Economic Indicators: United Kingdom & South West England

United Kingdom		1999	2000	2001	2002	2003	2004	2005	2006	2006				2007		
										Q1	Q2	Q3	Q4	Q1	Q2	
Real Gross Domestic Product – growth (% ch.) ¹		3.0	3.8	2.4	2.1	2.8	3.3	1.8	2.8	2.4	2.8	3.0	3.1	3.0	3.0	
Inflation – Consumer Price Index (CPI) (%)		1.3	0.8	1.2	1.3	1.4	1.3	2.1	2.3	1.9	2.3	2.4	2.7	2.9	2.6	
Trade balance (£bn)		-15.5	-19.4	-26.8	-30.9	-29.4	-35.0	-44.2	-54.4	-13.4	-15.9	-13.0	-12.1	-12.3	-	
Bank base rate (%) ²		5.50	6.00	4.00	4.00	3.75	4.75	4.50	5.00	4.50	4.50	4.75	5.00	5.25	5.50	
Exchange rates ³		€:£	1.519	1.642	1.609	1.591	1.446	1.474	1.463	1.467	1.457	1.454	1.471	1.485	1.492	1.473
		\$US:£	1.618	1.515	1.440	1.504	1.635	1.832	1.819	1.843	1.753	1.830	1.875	1.915	1.955	1.987
Employment rate (%) ⁴		73.8	74.4	74.6	74.4	74.7	74.8	74.7	74.6	74.5	74.6	74.6	74.5	74.5	74.3	
Unemployment rate (%) ⁵		6.1	5.6	4.9	5.2	5.0	4.8	4.7	5.4	5.1	5.2	5.5	5.6	5.5	5.5	
South West England		1999	2000	2001	2002	2003	2004	2005	2006	2006				2007		
										Q1	Q2	Q3	Q4	Q1	Q2	
Gross Value Added (GVA)	Total nominal GVA (£bn)	60.9	63.7	67.5	71.6	76.4	81.3	84.6	-	-	-	-	-	-	-	
	Annual growth (% ch.)	5.0	4.6	5.9	6.0	6.7	6.5	4.0	-	-	-	-	-	-	-	
	GVA per head (UK=100) ⁶	93.1	93.2	93.7	93.9	94.2	94.3	94.4	-	-	-	-	-	-	-	
	GVA per filled job (UK=100)	92.1	93.3	94.5	93.9	93.4	94.2	93.6	-	-	-	-	-	-	-	
	GVA per hour (UK=100)	93.4	95.0	97.3	96.0	95.7	97.1	95.8	-	-	-	-	-	-	-	
Gross Disposable Household Income (GDHI)	Total GDHI (£bn)	50.3	53.1	56.9	59.0	61.8	64.1	67.2	-	-	-	-	-	-	-	
	Annual growth (%)	4.7	5.7	7.1	3.6	4.9	3.6	4.9	-	-	-	-	-	-	-	
	GDHI per head (UK=100)	99.5	99.1	99.3	99.5	99.7	99.6	99.8	-	-	-	-	-	-	-	
Trade	Total goods exports (£bn)	7.3	7.6	8.2	7.5	9.1	9.7	10.3	11.0	2.7	2.8	2.7	2.8	3.1	-	
	Annual change (%)	3.6	3.6	8.1	-7.7	21.0	6.8	6.3	6.0	14.1	11.6	4.4	-4.3	13.6	-	
	Share of UK exports (%)	4.4	4.0	4.3	4.0	4.8	5.1	4.9	4.5	4.2	4.0	4.9	5.0	4.2	-	
Labour market	Employment rate (%) ⁴	78.3	78.9	78.9	79.0	78.8	78.7	78.4	78.2	78.1	78.4	77.8	78.4	78.0	-	
	Unemployment rate (%) ⁵	4.5	4.1	3.7	3.8	3.4	3.3	3.6	3.8	3.6	3.7	3.9	3.8	3.9	-	
House prices	Average house price (£k)	91.5	106.2	119.8	144.9	170.0	191.7	199.1	210.5	199.3	205.4	216.7	217.1	-	-	
	Annual change (%)	16.2	19.8	7.0	14.2	7.6	9.5	5.9	9.0	5.6	9.1	9.7	11.2	-	-	
	Index ⁷	94.5	97.8	100.3	104.7	108.6	107.2	104.8	103.2	103.1	102.5	102.3	104.4	-	-	
	Affordability ratio ⁸	5.9	6.4	6.9	7.9	8.9	9.8	9.6	9.7	-	-	-	-	-	-	

-Data unavailable; ¹ Percentages represent annual changes unless stated otherwise; ² Rate at end of period; ³ Annual and quarterly average rates; ⁴ As percentage of working age population;

⁵As percentage of economically active population aged 16+; ⁶ UK GVA per head for 2005 is £17,677; ⁷ England & Wales=100 latest quarter provisional only; ⁸ Ratio of average price to average total gross annual earnings. Sources: Exchange, interest rates – Bank of England; Trade – UKTradeInfo; House prices – ODPM (from Land Registry data); All other – ONS



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