

A GLOBAL CREDIT CRUNCH?:
MODELLING THE IMPLICATIONS FOR SOUTH
WEST ENGLAND
SWBEM BULLETIN
NOVEMBER 2007

BUSINESS AND ECONOMY

SUMMARY

- Global financial markets have been in turmoil since the summer. The outcome has been to reduce the availability, and increase the cost, of loans to all households and businesses, and particularly to higher risk borrowers.
- These events are likely to have a detrimental short run impact on global economic growth. However, the ultimate impacts of these events for particular economies remain highly uncertain.
- This bulletin explores alternative scenarios for the South West economy reflecting different assumptions concerning the severity and duration of the credit crunch. The analysis also takes account of the particular characteristics of the South West economy which will influence the regional impacts of the credit crunch:
 - The relatively high average debt burdens of South West households.
 - The region's relatively high house prices relative to average incomes.
 - The relative importance of small and medium-sized firms, who are likely to be particularly strongly affected by the credit squeeze.
 - The industry structure of the region, with a relatively small financial services sector (which is directly exposed to the effects of the squeeze) but relatively large manufacturing sector (which is more reliant on capital investment).
- The simulation results imply a medium-run (2007-2010) reduction in output growth ranging from 1.1 per cent for the more optimistic scenario to 2.3 per cent in the most pessimistic case.
- All scenarios assume that economic growth reverts to around its long-run trend from 2010 onwards, so that the longer-term impacts are less pronounced. Nevertheless, GVA in 2014 is between £6.8 billion (5 per cent) and £13.1 billion (9 per cent) lower than under the baseline projection without a significant credit squeeze, while employment is reduced by between 120,000 and 229,000 employee jobs.
- In all cases, the distribution of impacts across South West industries reflects the nature of the credit squeeze. Services are most strongly affected, particularly financial services and related business services. Growth of the construction sector is also strongly hit. The impacts are felt in all sub-regions of the South West.

OUR PARTNERSHIPS



INTRODUCTION

Global financial markets have been in turmoil since the summer following the spread of problems from US mortgage markets and associated securities which began to unfold during April 2007. The effect of complex interactions within financial markets across the world has been to reduce the willingness and ability of UK banks to lend to each other and, increasingly, to restrict lending to both commercial and domestic customers. A key element of this has been a long-overdue increase in the 'price of risk' - i.e. an increase in the interest rate differential (or 'spread') between lower and higher risk loans. The squeeze is therefore both restricting credit and increasing interest rates to higher risk borrowers in particular.

These events are likely to have a detrimental short run impact on global economic growth. However, the ultimate impacts of these events for particular economies remain highly uncertain. This bulletin explores alternative scenarios for the South West economy. The analysis presented in this bulletin seeks to illustrate the types of changes that might occur within the South West in response to specific changes in economic conditions resulting from a global credit crunch. This analysis utilises models of the South West economy developed by the South West Observatory: Business & Economy.

IMPLICATIONS FOR THE GLOBAL ECONOMY

The emerging consensus is that these events will have a detrimental impact on global economic growth, at least in the short term. The most recent IMF projections for global growth, for example, revise the forecast growth rate for global output in 2008 downwards by almost ½ percentage point, from around 5.25 to 4.75 per cent. There are also significant risks of a more substantial downturn in growth, particularly if financial markets take longer than expected to return to more 'normal' operating conditions.

The outturn of the US economy is critical to what happens to global growth over the next few years. US financial markets remain fragile and the dollar has depreciated strongly over recent months. This may have strongly detrimental effects for the US financial services sector – a core part of many urban economies – with knock-on effects across business services more generally.

The US housing market, in particular, shows no sign of recovering from the recent slowdown and property prices continue to fall in many areas. The apparent stabilisation of US house prices towards the end of 2006 has been disrupted by the credit market crisis, and this has raised the distinct prospect of a 'double-dip' housing downturn.

The weaker housing market in the US poses a direct threat to the construction sector, but is also likely to result in weaker consumption demand as households face both higher borrowing costs and the realisation that their personal wealth has been depleted (or, at least, is growing more slowly than previously anticipated). The negative impact on household expenditure may also be exacerbated by weaker labour market conditions, particularly if unemployment rises sharply. Moreover, the weak dollar means that there will be a tendency for US consumption to be diverted towards domestic suppliers and away from imports, which are now more expensive in dollar terms. We would expect this to include a reduction in foreign tourism by US citizens.

The current consensus is that the US is likely to avoid a full-blown recession. The IMF, for example, expects US real growth to slow to around 1.9 per cent during 2008. This is 1 per cent less than in previous IMF forecasts. The risks remain, however, that a combination of weakening housing markets and an extended period of credit tightening lead to larger than anticipated falls in consumer expenditure, while business confidence declines and rising inflationary pressures from higher fuel costs and other commodity prices and the falling dollar reduce the scope of the Federal Reserve to cut interest rates to support growth. In that case, an actual recession in the US is by no means out of the question.

Given weaker growth in the major developed economies, continued global economic growth is reliant on the continuing strength of the emerging Asian economies – particularly China and India – and also the resurgence of other major economies such as Russia (which is set to grow by around 8 per cent during 2007, according to IMF estimates, and is expected to grow strongly next year). There are, however, concerns that the Asian economies will also suffer significantly from any downturn in the US and Europe, which represent important export markets for Asian goods and services. Any significant reversal in the developed economies is likely to result in weaker growth in China and India.

PROSPECTS FOR THE UK ECONOMY

To date, the main forecasting agencies have made only marginal adjustments to their projections for the UK economy following the financial market turmoil of the last few months (Table 1). At the same time, the estimates for economic growth during 2007 have generally been adjusted upwards lightly, so that projections for growth over 2007 and 2008 as a whole are barely changed. Nevertheless, as new forecasts emerge, it is clear that a trend to downgrade 2008 forecasts is under way.

In the main, the reasoning behind this appears to be that a severe ‘credit crunch’ is unlikely to occur in the UK, and that financial markets will recover reasonably quickly from recent events. Given this, most forecasters predict a marginal slowdown in consumer expenditure growth and business investment, while the sterling’s recent appreciation against the US dollar, and weaker conditions in the US and EU are expected to constrain export growth (although depreciation against other currencies will help support exports in other markets). Slower expenditure growth, and higher borrowing costs, will also subtract from tax receipts and put increased pressure on government finances, possibly constraining the growth of public expenditure.

These negative factors are expected to be partially offset by weaker growth of imports (rising imports tend to detract from economic growth in the short-run), so that overall growth of output (GDP) is only slightly weaker during 2008 than previously expected.

Table 1: Forecasts for the UK Economy

	Forecast as of:						
	Actual 2006	September 2007		October 2007		2008 (Range)	
		2007	2008	2007	2008	Max	Min
<i>Growth of:</i>							
GDP	2.7	2.9	2.3	3.0	2.1	2.8	-0.3
Private Consumption	2.0	2.6	2.0	2.8	1.9	3.2	-0.2
Government Consumption	2.4	2.0	2.4	1.9	2.4	3.2	1.1
Fixed Investment	6.5	5.7	3.0	5.4	2.6	5.3	-0.8
Exports	11.6	-5.9	4.9	-5.2	4.7	7.2	-0.9
Imports	11.8	-5.0	4.5	-3.6	3.9	7.0	-1.5
Consumer Prices (CPI)	2.3	2.1	2.0	2.0	2.0		
Average Earnings	4.5	4.0	4.2	3.9	4.1		
Employment	0.8	0.7	0.8	0.7	0.7		
Interest Rate	5.00	5.75	5.50	5.80	5.30		

Source: HM Treasury, Forecasts for the UK Economy

RISKS TO THE UK ECONOMY

The discussion above suggests a consensus forecast for a relatively benign outcome for the UK economy, with growth only marginally below that assumed by the recent BEM projections for the South West (published during October 2007).

This outcome is, however, by no means guaranteed. As we have noted, a number of risks remain for the short term prospects of the global economy in general, and the UK in particular, following on from recent financial market turbulence:

- US growth may turn out weaker than currently expected suppressing growth in all major economies.
- A prolonged credit crunch may occur in the UK if banks' balance sheets turn out to be weaker than currently believed, and if it takes longer than anticipated for confidence in the credit markets to be restored. This could result in stricter constraints on borrowing, and higher costs for high-risk borrowers, over a prolonged period – depressing consumption and investment demand.
- A more prolonged credit squeeze, combined with weaker labour market conditions, could contribute to the long-predicted 'correction' in UK housing markets – with the possibility of actual falls in house prices. The IMF, for example, continues to argue that UK housing is significantly overvalued – with prices believed to be around 10% above sustainable levels in general, and more significant 'bubbles' in some areas. The strength of house prices has been a major factor supporting UK consumer expenditure over recent years, and a reversal here could spark a much more substantial decline in household spending than is currently anticipated by most forecasters.
- The ability of UK financial services to quickly recover from currently adverse conditions is also a major factor. Financial services account for around 4% of UK employment, but almost 10% of UK output, and support a significant amount of activity in professional and business services. A strong financial services sector is vitally important to the efficient functioning of the UK economy and a steep and/or prolonged decline in financial services would have serious implications for all other areas of the economy.
- The growth slowdown may well be exacerbated by the coincident timing of cutbacks in government expenditure growth as part of the recent Comprehensive Spending Review (CSR).

These factors imply a real possibility that UK growth may turn out to be much weaker during 2007-2009 than most forecasters are currently predicting. In the worst case, a combination of the more pessimistic scenarios could result in recession in the UK, although this is currently seen as an unlikely outcome.

RISKS TO THE SOUTH WEST ECONOMY

The particular circumstances of the South West may also mean that the region is affected differently from the UK as a whole:

- Available data suggests that South West residents are more burdened by debt (relative to income) than those of other UK regions. The most recent estimates by Experian Business Strategies suggest a household debt-to-income ratio of around 2.1 for the South West compared to around 1.6 for the UK as a whole. Higher debt levels will mean that prolonged borrowing restrictions and higher interest rates will have a stronger negative impact on South West households than those elsewhere, while the distribution of this 'average' effect will be heavily skewed by demographic group (tending to favour older residents) and by geographical area.
- Overall, the South West also has relatively high house prices, particularly when measured relative to average incomes. The region's house-price-to-income ratio is the third highest in the UK (at 7.9 compared to a UK average of 6.8 according to estimates from Experian), with particularly severe problems in some areas. Poor housing affordability could suggest that any national housing deflation is amplified within the South West, with detrimental consequences for the region's construction sector, for industries reliant on consumer expenditure, and more generally.

- Tighter lending conditions, and a higher risk premium, may impact particularly strongly on small and medium size businesses – which rely more heavily on debt than do larger firms, and which are generally seen as higher risk. The South West has a higher than average concentration of smaller businesses, and a continued credit squeeze, or a more severe credit ‘crunch’ will undermine investment in this sector, and will even pose a direct threat to the survival of some firms.
- The South West economy is more reliant on manufacturing and on public services than is the UK as a whole. Most commentators currently see manufacturing industries performing strongly over the next few years. However, manufacturers are more reliant on fixed investment than are services and credit constraints could bind particularly tightly here. In addition, manufacturing is more export oriented than services, and could suffer more from a weaker global economy. In addition, weaker tax revenues and higher debt servicing costs may constrain growth of public expenditure even more than is currently expected.
- On the other hand, the South West has a relatively small financial services sector (at least when compared to the greater South East and the UK as a whole) and also smaller professional and business services sectors, which are less strongly tied into global financial services than is the case in London for example. This should mean that the South West is relatively less susceptible to a downturn in these areas than are other regions of the UK.

GROWTH SCENARIOS

To allow for the possibility of more severe effects from the credit crunch, we consider a range of alternative scenarios for the UK and South West economies. We also update the main indicators within the South West projections in line with more recent published forecasts. The basic assumptions underlying these scenarios are presented in Table 2.

Table 2: UK Growth Scenarios

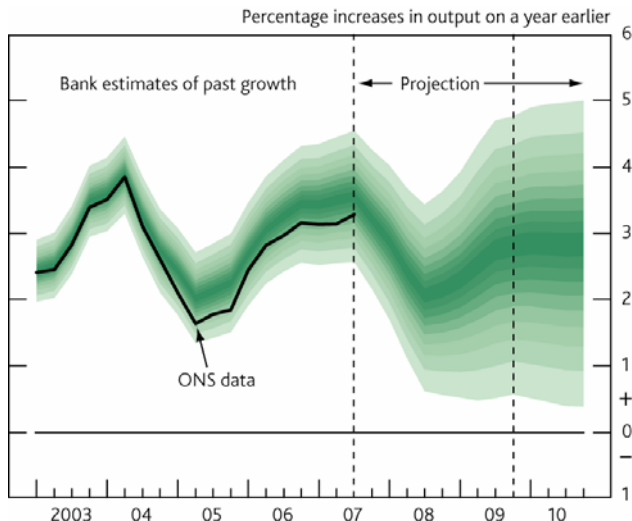
	GDP	Private Consumption	Government Consumption	Fixed Investment	Exports	Imports
Baseline Projection						
2007	3.0	2.8	1.9	5.4	-5.2	-3.6
2008	2.1	1.9	2.4	2.6	4.7	3.9
2008-14	2.6	2.6	2.2	2.6	2.5	2.5
Scenario 1						
2007	2.7	2.8	1.8	5.0	-6.0	-4.0
2008	1.1	0.7	1.4	1.4	3.7	2.9
2008-14	2.2	2.3	1.8	2.3	2.2	2.1
Scenario 2						
2007	2.3	2.3	1.8	2.3	-5.2	-3.6
2008	0.8	0.7	1.2	1.0	1.0	1.0
2008-14	1.8	1.8	1.6	1.7	1.3	1.4
Scenario 3						
2007	2.3	2.3	1.8	2.3	-5.2	-3.6
2008	-1.1	-1.5	1.2	-5.0	1.0	-2.5
2008-14	1.6	1.8	1.6	1.5	1.6	2.0

The baseline projection assumptions are based on the median forecasts for 2007 and 2008 from the October 2007 edition of the HM Treasury’s *Forecasts for the UK Economy*. Growth is expected to revert to trend after a dip during 2008, and to continue according to the latest HM Treasury growth projections as published in the pre-Budget Report.

Scenario 1 assumes a slightly more severe slowdown than in the baseline case, with UK growth for 2007 turning out to be slower than expected. This reflects a degree of uncertainty over the preliminary UK output estimates for the year to date, and a view that growth in the remainder of the year may be weaker than had been anticipated. Thereafter, the scenario is

based on a marked deceleration of growth in 2008, slowing by around 1% overall. This is in line with Item Club and IMF assumptions on the impact of a more severe credit crunch. Thereafter, growth remains weak during 2009 and continues around ¼ point below Treasury expectations for the remainder of the projection period.

Figure 1: Range of Bank of England Forecasts for the UK

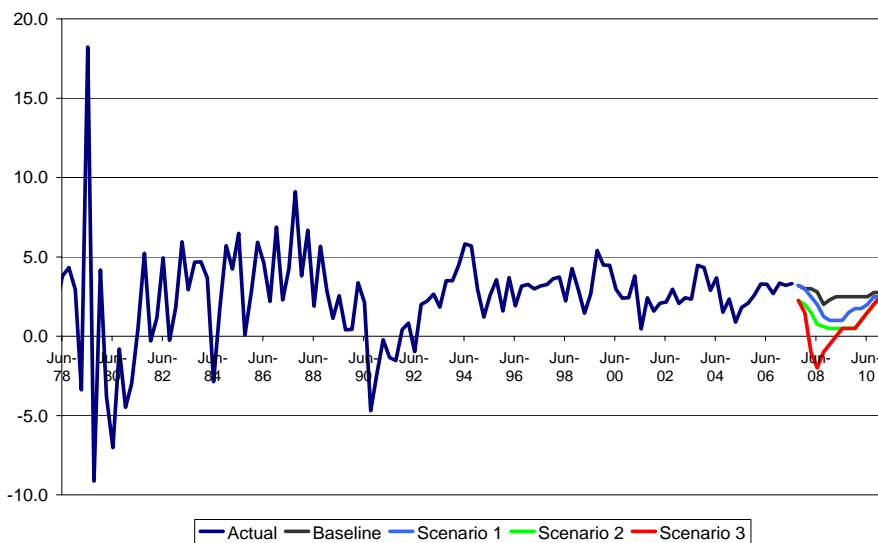


Source: Bank of England Inflation Report, November 2007

Scenario 2 is based on the most pessimistic growth projections within the Bank of England's 'fan chart' for the UK economy – Figure 1. In this case, the outturn for 2007 is even weaker than assumed under Scenario 1. UK growth is assumed to decline sharply after the third quarter of 2007 and to remain weak until 2010, before gradually rising towards the long run trend, to continue at around ¼ point below Treasury expectations for the remainder of the projection period.

Scenario 3 is yet more pessimistic still. It makes the same assumption as under Scenario 2 for growth in 2007, but then allows for a full-blown recession in the UK during 2008-9, of a similar magnitude to that of the early 1990s. Real UK output is assumed to fall during 2008 and the first part of 2009, and thereafter to grow more slowly than implied by the Treasury long-run growth trend, as under Scenario 2.

Figure 2 presents the projected time paths for UK growth associated with these scenarios.

Figure 2: UK GDP Growth Scenarios

Source: SWBEM

We also allow for the particular circumstances of the South West by superimposing on the projections for Scenarios 1 and 2, the impact of a (marginally) sharper decline in consumer expenditure and construction than nationally (reflecting higher debt burdens and the higher house-price-to-income ratio), but stronger growth in financial and business services than would be implied by the national assumptions.

RESULTS

The main results for these scenarios are reported in Table 3 and 4 (below). The **baseline** shows a marginal increase in growth during 2007 compared to the Autumn BEM projections, offset by a marginal decline in growth during 2008. The overall effect is, however, to raise GVA, GVA per head and total employment in the South West slightly over the medium term (to 2014), relative to our previous projections.

Scenario 1 suppresses growth over the short and medium term, which leads to a slight reduction in output and employment relative to the baseline at the end of the projection period. Total projected South West GVA in 2014 is around £7 billion less (around 5 per cent) and GVA per head to be around £1,300 less by 2014 under Scenario 1 than under the baseline. The average annual growth rate of nominal (current price) GVA falls from 5.9 per cent a year in the baseline projection to 5.3 per cent under this Scenario. The slowdown is, however, concentrated during the period to 2010. During 2006-2010, the average growth rate of South West nominal GVA is almost 1 percentage point slower than in the baseline case.

Employment growth is also more muted, with total employee jobs growing by an average rate of 1.6 per cent a year during 2006-2014 as compared to 2.2 per cent a year in the baseline projection. This implies around 120,000 fewer employee jobs in the region by 2014.

Most South West industries are affected by the slowdown, although the largest impacts are in the services sectors, particularly financial services and business services (Table 4). The scenario is also associated with significantly lower growth in the construction sector.

Table 5 presents the results for South West sub-regions. The wide impact across industries implies that the impacts are not strongly concentrated in particular sub-regions, but are widely spread geographically across the regions. Thus, all sub-regions are adversely affected relative to the baseline projections. In part, this reflects the fact that the simulations do not explicitly

include any direct spatial bias in the impact of the credit squeeze – so that sub-regional differences only reflect industry structure effects.

Scenario 2 shows the impact of a more severe and longer credit crunch, which has a more significant detrimental impact on economic activity at both national and regional levels. The impact on average growth over the medium term again looks fairly modest compared to the baseline, with the South West economy growing by an average rate of 4.9 per cent a year in nominal terms to 2014 compared to the baseline projection of 6.0 per cent a year. This, however, results in South West GVA being around £11 billion (8 per cent) lower by 2014 than it would have been in the absence of this more severe global credit crunch effect. By 2014, South West GVA per head is around £2,000 lower than in the baseline case. Employment growth also declines markedly, to around 1.2 per cent a year, so that the region supports almost 190,000 fewer employee jobs than in the absence of a credit crunch. As with Scenario 1, the largest impacts are in the service sectors, and particularly in Financial Services, Construction and Business Services. Hotels & Restaurants also suffer from slowdowns in household expenditure and exports. The economic growth slowdown is broadly spread across South West sub-regions, with a very marginal concentration in the Bristol city region.

Table 3: Impact of Credit Crunch Scenarios

	2006	2007	2008	2009	2010	2014	Average Annual Growth Rate (%) 2006-14
GVA (£m, current price)							
Baseline							
South West	89,700	96,600	101,300	107,100	113,300	142,300	5.9
UK	1,123,400	1,209,200	1,268,800	1,336,600	1,411,000	1,786,900	6.0
Scenario 1							
South West	89,700	96,400	99,900	104,400	109,500	135,500	5.3
UK	1,123,400	1,206,900	1,250,600	1,300,500	1,361,600	1,698,800	5.3
Scenario 2							
South West	89,700	95,700	99,100	103,300	106,900	131,400	4.9
UK	1,123,400	1,197,700	1,239,600	1,285,600	1,327,700	1,646,200	4.9
Scenario 3							
South West	89,700	95,700	98,400	101,800	105,200	129,200	4.7
UK	1,123,400	1,197,700	1,231,900	1,266,000	1,305,500	1,617,500	4.7
GVA per head (£, current price)							
Baseline							
South West	17,500	18,800	19,600	20,600	21,600	26,500	5.3
UK	18,600	19,900	20,800	21,800	22,900	28,500	5.5
Index (UK = 100)	94.1	94.5	94.2	94.5	94.3	93.0	
Scenario 1							
South West	17,500	18,700	19,300	20,000	20,900	25,200	4.7
UK	18,600	19,800	20,500	21,200	22,100	27,100	4.8
Index (UK = 100)	94.1	94.4	94.1	94.3	94.6	93.0	
Scenario 2							
South West	17,500	18,600	19,100	19,800	20,400	24,500	4.3
UK	18,600	19,700	20,300	21,000	21,500	26,200	4.4
Index (UK = 100)	94.1	94.4	94.1	94.3	94.9	93.5	
Scenario 3							
South West	17,500	18,600	19,000	19,500	20,100	24,000	4.0
UK	18,600	19,700	20,200	20,600	21,200	25,800	4.2
Index (UK = 100)	94.1	94.4	94.1	94.7	94.8	93.0	
Employment (ABI Employee Jobs)							
Baseline							
South West	2,252,500	2,344,600	2,367,800	2,421,500	2,463,900	2,675,600	2.2
GB	26,557,500	27,493,700	27,711,200	28,096,900	28,473,900	30,717,100	1.8
Scenario 1							
South West	2,252,500	2,343,200	2,339,900	2,363,600	2,385,900	2,555,400	1.6
GB	26,557,500	27,479,300	27,416,000	27,490,800	27,663,200	29,478,700	1.3
Scenario 2							
South West	2,252,500	2,326,500	2,326,100	2,343,300	2,334,000	2,486,600	1.2
GB	26,557,500	27,299,800	27,270,200	27,275,800	27,122,300	28,766,500	1.0
Scenario 3							
South West	2,252,500	2,327,900	2,303,700	2,311,100	2,298,500	2,446,900	1.0
GB	26,557,500	27,313,700	27,015,900	26,936,000	26,748,300	28,353,300	0.8

Source: SWBEM

Scenario 3 is based on our most pessimistic assumptions concerning the severity and impact of a global credit crunch. In this case, the South West suffers a recession during 2008, although this is masked by our use of current price GVA estimates (which include the effects of inflation). Nominal GVA growth averages only 3.2 per cent a year during 2007-2010. The longer term effect is to restrict GVA growth during 2006-2014 to around 4.7 per cent a year, compared with 5.9 per cent in the baseline projection. Total regional GVA is around £13 billion less (in nominal terms) and GVA per head £2,500 less during 2014 than in the absence of a credit crunch.

Employment falls by over 24,000 (on an employee job basis) during 2008, and then struggles to recover until after 2010, finally rising by around 195,000 over the period 2006-2014 as a whole. This leaves total employment in 2014 at around 229,000 (9 per cent) less than in the baseline projection. The industry pattern of impacts is essentially the same as under the less severe credit crunch scenarios, as is the sub-regional pattern of impacts.

Table 4: Impact on Growth of South West Industries

	Value, 2014				Average Growth Rate (%), 2006-14			
	Baseline	Scenario 1	Scenario 2	Scenario 3	Baseline	Scenario 1	Scenario 2	Scenario 3
GVA (£m, current prices)								
Agriculture, hunting, forestry & fishing	1,600	1,600	1,610	1,670	-2.8	-2.8	-2.7	-2.2
Mining & Quarrying	380	370	370	370	-0.6	-1.0	-1.0	-1.0
Manufacturing	12,550	12,410	12,340	12,430	0.0	-0.1	-0.2	-0.1
Electricity, gas and water supply	1,930	1,930	1,950	1,970	1.8	1.8	2.0	2.1
Construction	11,650	10,980	10,460	10,130	7.2	6.4	5.7	5.3
Wholesale and retail trade (including motor trade)	17,890	17,090	16,610	16,230	6.5	5.9	5.5	5.2
Hotels and restaurants	6,220	5,840	5,580	5,430	7.9	7.1	6.5	6.1
Transport, storage and communication	8,390	8,140	8,000	7,930	5.4	5.0	4.8	4.7
Financial intermediation	10,230	9,410	8,900	8,760	5.0	3.9	3.2	3.0
Real estate, renting and business activities	41,240	38,630	37,050	35,860	8.8	7.9	7.3	6.9
Public administration and defence	6,430	6,330	6,300	6,350	2.3	2.1	2.1	2.2
Education	9,110	8,780	8,650	8,560	6.9	6.4	6.2	6.1
Health and social work	12,400	11,850	11,590	11,500	6.9	6.3	6.0	5.9
Other services	8,340	7,910	7,660	7,530	8.4	7.7	7.3	7.1
TOTAL	142,270	135,470	131,420	129,180	5.9	5.3	4.9	4.7
Employment (Employee Jobs, thousands)								
Agriculture, hunting, forestry & fishing	14.6	14.6	14.7	15.3	-9.3	-9.3	-9.2	-8.7
Mining & Quarrying	3.5	3.5	3.4	3.4	-5.1	-5.1	-5.4	-5.4
Manufacturing	187.7	185.6	184.5	185.9	-3.7	-3.9	-3.9	-3.8
Electricity, gas and water supply	7.1	7.1	7.2	7.2	-3.2	-3.2	-3.0	-3.0
Construction	106.6	100.5	95.7	92.6	0.1	-0.7	-1.3	-1.7
Wholesale and retail trade (including motor trade)	495.7	473.6	460.2	449.8	2.4	1.8	1.5	1.2
Hotels and restaurants	224.4	210.8	201.3	195.9	3.4	2.6	2.0	1.7
Transport, storage and communication	133.0	129.1	126.9	125.8	2.4	2.0	1.8	1.7
Financial intermediation	55.8	51.3	48.5	47.7	-5.9	-6.9	-7.5	-7.7
Real estate, renting and business activities	471.3	441.5	423.4	409.8	5.3	4.4	3.9	3.5
Public administration and defence	128.4	126.2	125.8	126.7	-0.1	-0.3	-0.4	-0.3
Education	348.5	336.0	331.0	327.4	5.5	5.1	4.9	4.7
Health and social work	359.7	343.7	336.0	333.5	2.5	1.9	1.7	1.6
Other services	139.3	132.1	128.0	125.8	4.0	3.3	2.9	2.7
TOTAL	2,675.6	2,555.4	2,486.6	2,446.9	2.2	1.6	1.2	1.0

Source: SWBEM

Table 5: Sub-Regional Impacts of Credit-Crunch Scenarios

	Value, 2014				Average Annual Growth Rate, 2006-2014			
	Baseline	Scenario 1	Scenario 2	Scenario 3	Baseline	Scenario 1	Scenario 2	Scenario 3
GVA (£m, current prices)								
South West	142,300	135,500	131,400	129,200	5.9	5.3	4.9	4.7
Gloucestershire, Wiltshire and North Somerset	80,800	76,900	74,600	73,300	6.5	5.8	5.4	5.2
Bristol City of	15,800	15,000	14,600	14,300	5.6	4.9	4.5	4.3
North and North East Somerset, South Gloucestershire	23,100	22,000	21,400	21,000	7.2	6.5	6.1	5.9
Gloucestershire	22,000	20,900	20,300	20,000	7.2	6.6	6.2	5.9
Swindon	8,700	8,200	8,000	7,900	6.2	5.5	5.1	4.9
Wiltshire CC	11,200	10,600	10,300	10,100	5.2	4.5	4.1	3.9
Dorset and Somerset	28,300	26,900	26,200	25,700	5.4	4.8	4.4	4.2
Bournemouth and Poole	9,100	8,600	8,400	8,200	6.5	5.9	5.5	5.2
Dorset CC	7,500	7,100	6,900	6,800	4.3	3.7	3.3	3.1
Somerset	11,700	11,200	10,900	10,700	5.3	4.7	4.3	4.1
Cornwall and Isles of Scilly	10,800	10,300	10,000	9,800	6.6	5.9	5.5	5.3
Devon	22,500	21,400	20,700	20,400	4.6	3.9	3.5	3.3
Plymouth	4,800	4,600	4,400	4,300	3.4	2.8	2.4	2.1
Torbay	1,400	1,300	1,300	1,300	0.0	-0.7	-1.0	-1.3
Devon CC	16,300	15,500	15,000	14,800	5.5	4.8	4.4	4.2
GVA per Head (£, current prices)								
South West	26,300	25,100	24,300	23,900	5.3	4.6	4.3	4.0
Gloucestershire, Wiltshire and North Somerset	34,500	32,900	31,900	31,300	5.9	5.3	4.9	4.6
Bristol City of	38,000	36,100	35,000	34,400	5.1	4.4	4.0	3.8
North and North East Somerset, South Gloucestershire	35,300	33,600	32,600	32,000	6.5	5.9	5.5	5.3
Gloucestershire	36,700	35,000	34,000	33,400	6.8	6.2	5.8	5.6
Swindon	45,800	43,500	42,200	41,500	5.8	5.2	4.7	4.5
Wiltshire CC	23,300	22,200	21,500	21,100	4.5	3.9	3.5	3.2
Dorset and Somerset	21,900	20,900	20,300	19,900	4.8	4.2	3.8	3.6
Bournemouth and Poole	29,500	28,100	27,200	26,700	6.3	5.7	5.3	5.0
Dorset CC	17,500	16,700	16,300	16,000	3.7	3.1	2.8	2.6
Somerset	21,000	20,100	19,500	19,200	4.5	3.9	3.5	3.3
Cornwall and Isles of Scilly	18,900	18,000	17,400	17,200	5.6	5.0	4.6	4.4
Devon	18,600	17,700	17,200	16,900	3.8	3.1	2.7	2.5
Plymouth	18,900	17,900	17,400	17,100	3.1	2.4	2.0	1.8
Torbay	9,500	9,000	8,700	8,500	-1.0	-1.6	-2.0	-2.2
Devon CC	20,300	19,300	18,700	18,400	4.5	3.9	3.5	3.3

Source: SWBEM

CONCLUSIONS

The increasing inter-dependence of nations and regions within the global economy means that all areas are exposed, to a greater or lesser extent, to major disruptions in key global markets. The initial source of the global credit crunch was a downturn in the US housing market. The effect has been to tighten credit throughout the global economy. The ultimate impacts remain uncertain, but a slowdown in UK growth appears inevitable even under the most optimistic assumptions and a more severe and prolonged impact – even a recession – is possible.

This bulletin has investigated the implications of the global credit crunch for the economy of the South West England, by simulating the effects of 3 credit crunch scenarios, of increasing severity, using economic models of the region developed by SWBEM. The results imply a medium-run (2007-2010) reduction in output growth ranging from 1.1 per cent for the more optimistic scenario to 2.3 per cent in the most pessimistic case. All scenarios assume that economic growth reverts to around its long-run trend from 2010 onwards, so that the longer-term impacts are less pronounced. Nevertheless, GVA in 2014 is between £6.8 billion (5 per cent) and £13.1 billion (9 per cent) lower than under the baseline projection without a significant credit squeeze, while employment is reduced by between 120,000 and 229,000 employee jobs.

In all cases, the distribution of impacts across South West industries reflects the nature of the credit squeeze. Services are most strongly affected, particularly financial services and related business services. Growth of the construction sector is also strongly hit. The impacts are felt in all sub-regions of the South West.

SW BEM

The Business and Economy Module of the South West Observatory provides a dynamic source of economic and business research and intelligence, with comprehensive data and analysis to support regional development and evidence based decision making. To improve the availability of regional data the Business and Economy Module has developed a set of Regional Accounts which are freely available to all. For further information please visit the Business and Economy Module website (www.swo.org.uk/bem).

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