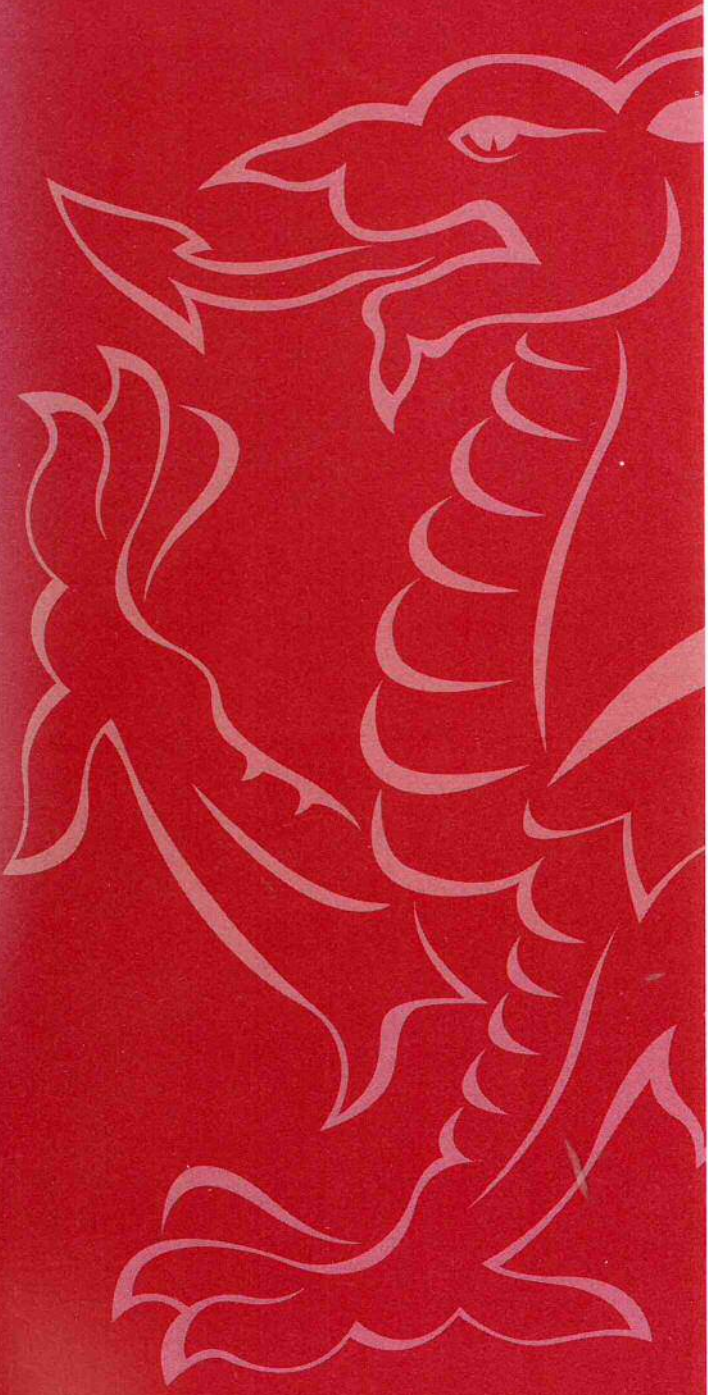


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#### **Notes for Contributors**

Authors should send papers for potential publication in the *Welsh Economic Review* to the Editor at the address given below, preferably via e-mail in a Word for Windows format. Papers are welcome on any topic that would be of general interest to the readership, and should be written in a style suitable for non-specialist readers. Papers should be approximately 3,000-4,000 words and any graphs or figures should be accompanied by the underlying data to allow reproduction.

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# Economic Commentary

## The World Economy

According to the Organisation for Economic Co-operation and Development (OECD) there is now some growth momentum in world economies resulting from a number of factors, such as early signs of recovery in the ICT sectors, a faster than expected return to confidence following events of September 11<sup>th</sup> 2001, and the stimulus provided by economic policy in the US and other countries following the terrorist attacks. However, the OECD remains cautious, and notes that economic uncertainties remain in many member countries. Economic growth in the OECD area is expected to reach around 2% in 2002, and 3% by 2003.

The US economy, largely propped up by consumer spending, suffered only a short recession during 2001, and is expected to grow by around 2.5% this year, rising still further in 2003. Recovery is supported by increased exports and investment activities. The US labour market, however, remains relatively weak. Whilst the unemployment rate has fallen slightly over recent months, to 5.7% in August 2002, it is still above rates of the previous year. In addition uncertainty continues in equity markets in the US, partly a consequence of the recent wave of American corporate scandals, and a possible war against Iraq. Interest rates in the US remain at a 40 year low. The Federal Reserve (Fed) could come under pressure to increase rates if growth accelerates over the next year. Figures for industrial production will add some strength to the OECD suggestion that interest rates should be raised. US Industrial production increased in July for the seventh consecutive month, although this was followed by a small decline in industrial output in August.

The Japanese economy appears to be slowly recovering after a significant downturn. Output growth in 2002Q2 was revised up to an annual rate of 2.6%, although other indicators, such as retail sales volumes, which fell by 4.8% in the year to July, reveal a still fragile economy. Overall Japanese output growth for 2002 is expected to fall in real terms, however recovery is expected in 2003. The Economist poll predicts Japanese output growth of around 1.2% in 2003, however the OECD is more cautious, expecting growth of just 0.3%.

In September, the monthly Economist poll of forecasters revised GDP growth down in the Euro area for 2002 and 2003 for the third consecutive month. Output growth in the Euro area is now expected to be around 1% for 2002, and 2.4% in 2003. Industrial production and retail sales volumes both fell in the year to June, whilst there were some concerns that a stronger Euro may weaken growth rates through its impact on export sales. Despite inflation rates exceeding the 2% target rate in August, the European Central Bank is unlikely to raise interest rates until recovery is more firmly established.

In Germany, Europe's largest economy, output grew only very modestly (by less than 1%) during 2001, with little change expected for 2002. Industrial activity fell by 2% in the year to July 2002, and unemployment rates are still well above the EU average. Over the same period, declines in industrial production were also experienced in France (-1.7%), Denmark (-1.6%) and Italy (-5.4% in the year to June).

Latest figures for world foreign direct investment (FDI) flows, show a downturn in activity during 2001, with flows to developed countries falling by nearly 50%. The United Nations Conference on Trade and Development (UNCTAD) had expected a decline, due to the slowdown of world economic growth during 2001. In addition, there has been a decrease in cross-border mergers and acquisitions (M&As).

Figure 1 shows FDI inflows to selected countries in 2000 and 2001. In the US, FDI flows fell from almost \$300bn in 2000 to almost \$150bn during January-September of 2001, whilst in the UK, FDI inflows fell by over 50% during the same period.

UNCTAD reports that company surveys suggest that the effects of September 11<sup>th</sup> on investment flows will be limited, as few firms were expecting to change their plans as a result of the attacks, although higher perceived risks may

encourage firms to delay or review investment intentions.

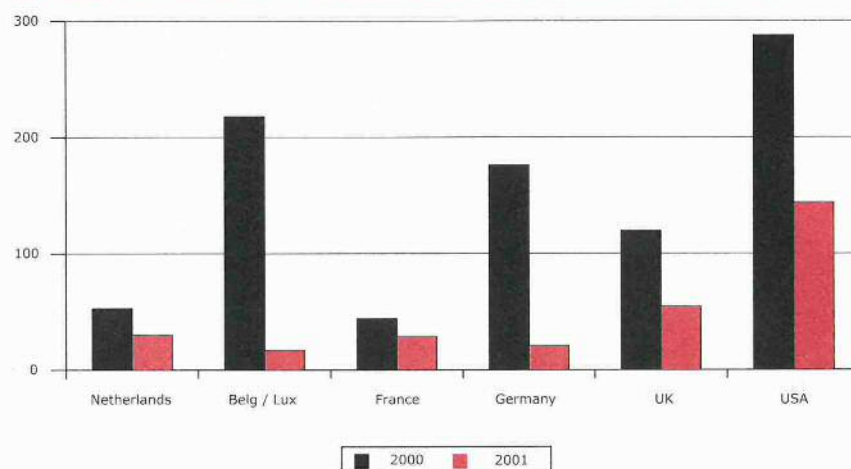
## The UK Economy

The UK economy is expected to grow by around 1.7% in 2002, and by 2.9% in 2003 (Economist poll). UK Consumer spending has remained relatively strong, a consequence of low interest, unemployment and inflation rates, and an exceptionally strong housing market (see Property section of this Review). The confident consumer market has offset the impact of weak export markets and low investment spending. During its September meeting, the Monetary Policy Committee voted to keep UK interest rates unchanged at 4%.

## ICT Investment and Educational Attainment in the UK

A recent report in the Economist commented on the relatively low levels of ICT investment in Britain, and the implications of this for productivity growth, which has been slowing in recent years (Economist 31<sup>st</sup> August 2002). According to this report the ICT share of total investment (excluding housing) in Britain is only half that of the USA and many other developed economies. In addition, Britain only accounts for around 2% of total R&D spending in ICT in the OECD area. Another link to Britain's recent poor productivity performance is educational attainment. Whilst the number of

Figure 1: FDI inflows for selected countries in 2000 and 2001<sup>1</sup>, \$bn



<sup>1</sup>January to September 2001

Source: UNCTAD (See [www.unctad.org](http://www.unctad.org))

graduates from UK universities is increasing, the number of students staying in school post 16 is low compared to many other nations (see below) – a problem for an economy which demands many workers with ‘intermediate skills’ (Economist June 29<sup>th</sup> 2002). A recent Department of Education Green Paper on 14-19 year-olds in education reported that the percentage of 17 year-olds in full-time education in the UK was less than 75%, compared with rates of just over 80% in the US and Ireland, over 90% in France, Germany, and Japan, and over 95% in Sweden (see [www.dfes.gov.uk/14-19greenpaper/](http://www.dfes.gov.uk/14-19greenpaper/)).

### The Welsh Economy

The (seasonally adjusted) ILO unemployment rate for Wales was 5.7% in the period May-July 2002, slightly above the UK average rate of 5.2%.

Welsh manufacturing output increased slightly during 2002Q2, after falling for seven consecutive quarters. However there is little hope of an imminent return to sustained growth. The July CBI/BSL manufacturing survey reported that Welsh manufacturers were expecting new orders to fall in the period to November (see Industrial Activity section of this *Review*). Manufacturers are suffering from weak demand in export markets, and the increasing cost competitiveness of overseas producers. The Welsh metals industry amongst others has recently announced further closures and redundancies. There is however some new hope for continued metal manufacturing at ASW in Cardiff, which had been placed in the hands of receivers in July. During late September it was reported that a potential buyer was in discussions with the company.

In other sectors of the Welsh economy there has been more positive news. The retailing sector, which has experienced growth in the UK overall as consumer demand remains strong, has announced a number of new ventures in Wales (See Diary section), whilst new call centre openings continue to be a regular feature of the Welsh economy. However, following the closure of ITV Digital’s call centre in Pembrokeshire earlier this year, a number of concerns have been expressed about the sustainability of call centre jobs in a world of ever changing technology.

### Factors Expected to Affect Long-Term Growth in the Welsh Economy

A number of factors are expected to affect the longer term growth prospects of the Welsh economy. The most important relate to the general health of the European and global economies. Expansion of the European Union would impact on the Welsh economy through, for example, increased competition for structural funds and FDI, whilst in the longer term, the UK’s decision on whether to join the single currency could have implications for the UK regions. These will depend in part on the joining criteria. Inclusion within the Euro area may affect factors such as trade flows, FDI and public spending. However, there are a series of more local factors that are also expected to shape long term regional economic prospects. These include:

- The Welsh Assembly Government has set ambitious targets for the economy over the next decade. Prospects for the economy depend, in part, on the success or failure of the Assembly to develop a strong set of policies, in close conjunction with its main regional partners, to address the underlying problems of the local economy, in terms of low activity rates, low earnings and a poor record in innovation, and new firm formation.
- The progress of re-adjustment in Welsh manufacturing. Wales continues to have a high share of manufacturing employment and output compared to the UK average, and this manufacturing activity supports jobs in other Welsh sectors. Whilst Welsh manufacturing output has been falling in the recent past, the success of the sector in re-adjusting to global economic pressures will be a critical factor in determining the Welsh economic trajectory.
- Related to the above, the extent to which the region will continue to attract foreign manufacturing and services investment, in an increasingly competitive location marketing environment, will influence Wales’ economic prospects. As was shown earlier in this commentary, global FDI flows fell during 2001.
- The efficiency with which EU structural funding can be employed

to address economic problems in the West Wales and the Valleys areas. Prospects for Wales can be improved by enabling these areas to play a full role in regional economic development processes.

- The extent to which new jobs created in financial and business services sectors in south east Wales are vulnerable to improvements in information technology, and further restructuring and consolidation in the largest service providers, threaten growth prospects for Wales.
- How effectively Cardiff can build upon a new political infrastructure and compete with other UK regional centres to attract high quality employment in the fastest growing national sectors is important for Wales.

### Forecasts

Forecasts of GDP change for 2003 and 2004 have been revised downwards to 1.8% and 2% respectively compared with those in the previous issue of the *Review*. Prospects in the manufacturing sector in the short term remain uncertain. Overall employment prospects in the year to 2002Q1 seem to have weakened. Whilst employment and GDP growth is expected to be generated through the service sector of the economy in the short to medium term, this will be modest, and likely to just offset negative changes elsewhere in the economy.

**Table 1: Forecast Change in Real GDP (%)**

	2002	2003	2004
Wales	1.0	1.8	2.0