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# Welsh Economic Review

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The *Welsh Economic Review* is produced twice yearly, by the Welsh Economy Research Unit (WERU) at Cardiff Business School. The aim of the *Review* is to provide an authoritative and objective analysis of the Welsh economy in a manner that promotes understanding and informs decision-making. The 'core' section of the *Review* is written by members of WERU, with feature articles contributed by academics or practitioners within or outside Wales. The *Review* is circulated widely within Wales, to both private and public sector organisations, including the education sector and the National Assembly.

#### **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

## World Economy

Towards the end of 2002, the OECD (and others), suggested there was some growth momentum in world economies, but cautiously noted the economic uncertainties in many member countries. Since then growth in many world economies has slowed. The end of the war in Iraq has removed some economic uncertainties, but problems remain, including corporate scandals, equity market problems, possible further terrorist attacks and geopolitical concerns. The International Monetary Fund (IMF) in its latest *World Economic Outlook* (published on April 9<sup>th</sup>), revised downwards growth projections made six months previously for the main industrial economies.

Since 1995 the US has accounted for over one half of the growth in the world economy (*Economist* 12 April 2003) and the IMF is now expecting the US to lead global recovery, with growth of 2.2% in 2003 and 3.65% in 2004. However the IMF warns against over-reliance on US growth as a world economy tonic. The US labour market is currently suffering from falling employment. In the year to March 2003, the number of workers on US payrolls fell by around 2 million. In its March meeting, the Federal Reserve Monetary Policy Committee kept US interest rates at 1.25%, although with the prospect of further rate reduction if economic conditions worsen. Fiscal policy has also been loosened, with higher spending, particularly on homeland security and the war in Iraq, and prospects of lower taxes. The US current account deficit is now over 5% of GDP, with further increases expected. This is considered to be unsustainable, with some prospect of a fall in the value of the dollar, having global economic consequences (*Economist* 12 April 2003).

In Japan, prices of goods and services have fallen for four consecutive years, with strong expectations of further price falls. In the year to February 2003, Japanese retail sales fell by 0.2%. The IMF's growth forecast for Japan has been revised down to 0.8%. To reverse Japan's economic fortunes the IMF and

others have suggested that structural problems in the banking and corporate sectors be addressed, and for the Bank of Japan to make a firm commitment to ending deflation.

Growth forecasts in other parts of Asia have been revised downwards. Prospects have been recently damaged as a result of the outbreak of Severe Acute Respiratory Syndrome (SARS). The main impact so far has been on tourism, although consumer spending is also falling. In Hong Kong retail sales fell by 50% in March, and there have been reports that people are staying home from work, with possible implications for output growth. Whilst the direct economic effects may be limited, assuming an early end to the outbreak, there may be longer term consequences for the economies of China and Singapore if investors increase their risk ratings for these areas.

In April 2003, the European Central Bank (ECB) decided to leave interest rates unchanged until the impact of the war is clearer. However, organisations such as the World Bank, the Institute of International Finance and the IMF have signalled a desire to see lower European interest rates. In the euro area service sector and manufacturing output has declined. In Germany, stagnation of the economy is of most concern. Bank profits, property prices and retail sales

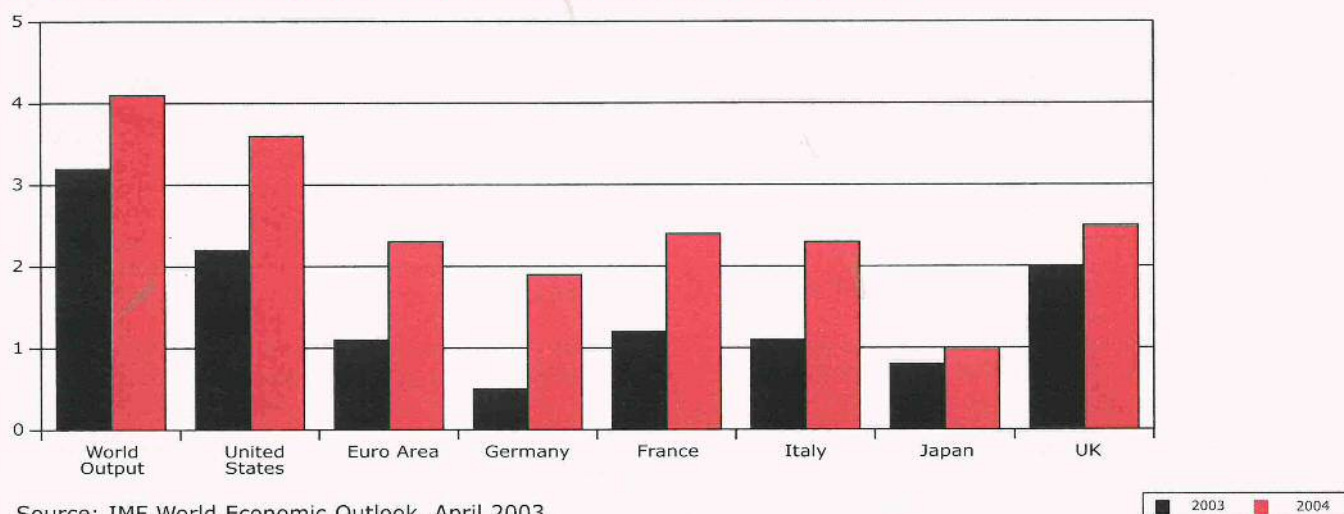
are weak, whilst corporate insolvencies are increasing, and the jobless rate is at a three year high. In March the German unemployment rate was 10.6%. The IMF expects the German economy to grow by 0.5% in 2003 and 1.9% in 2004. In France and Italy the prospects are a little better, with the IMF expecting growth in these economies to exceed 1% in 2003, and 2% in 2004. Figure 1 shows the IMF's forecasts for output growth in selected economies for 2003 and 2004.

## The UK Economy

The UK economy grew by an estimated 1.8% in 2002, the smallest increase since 1992. During 2002 manufacturing output fell by 4%, while service sector growth was 2.7% (also the lowest rate since 1992). While the Chancellor cut his growth forecast for 2003 to 2 – 2.5% in April's Budget, the 2004 forecast remained at 3 – 3.5%. These forecasts, particularly for 2004, slightly exceed those of the *Economist Poll*, the range of independent forecasts published by the Treasury and the IMF. The IMF, for example, forecast UK economic growth at 2% for 2003, and 2.5% for 2004 (see figure 1).

The Office for National Statistics (ONS) recently published trade data for the UK for February 2003. This data illustrated some of the implications of the poor

**Figure 1: Forecast Output Growth (annual % change), Selected Economies.**





performance of euro area economies, the patchy recovery in US markets, and the uncertainties in global demand linked to the war in Iraq. In February exports fell by 5% and imports fell by 1.5%, leaving a wider than expected trade in goods deficit. However, the UK maintains a surplus in trade in services, although that surplus declined slightly during February.

In March the Chartered Institute of Purchasing and Supply's (CIPS) monthly purchasing managers' index showed that manufacturing order books fell at their most marked rate for one-and-a-half years, the fourth consecutive month of decline. The index fell in March which CIPS said '*signaled the contraction of the UK manufacturing economy at a significant and increased pace*'.

UK consumer demand has however remained strong. For example, in February, retail sales volumes were 3.2% higher than in the previous year. The housing market has been crucial in sustaining the UK economy. Increasing property prices have enabled households to extract equity from their properties to finance their consumption. Another key domestic factor has been increased public spending. However, whilst there have been some signs of a slowdown in property markets in parts of the UK, the impacts are likely to be limited, particularly as the Bank of England still has some scope to further reduce interest rates. Whilst UK interest rates are at their lowest levels for

almost 50 years, these are still significantly higher than in the US and the euro area. At its February meeting, the Monetary Policy Committee cut interest rates to 3.75%, and at the March and April meetings this rate was left unchanged.

### The Welsh Economy

In line with the UK economy, Welsh economic growth will be supported by consumer demand and public spending. The public sector spending section of this Review explains the distribution of spending across main expenditure categories.

The seasonally adjusted unemployment claimant count rate was 3.5% in Wales in February 2003, compared with an average rate of 3.1% for the UK, and employment growth over the past year has been moderate. Despite problems in the manufacturing sector, there has been employment growth in private and public sector service sectors.

Table 1 presents forecasts for the Welsh economy for the period 2003-2005. In line with the downgrading of forecasts for the UK (and world) economies, the forecasts for 2003 and 2004 have been revised slightly downwards to 1.2% and 1.5% respectively. Forecast GDP growth for 2005 is 2%, although with the current uncertainties in the world economy, making forecasts for even one or two years hence is extremely problematic.

### The Budget – some interesting announcements.

Whilst the April budget was generally regarded to be '*the least substantial budget of his (the Chancellor's) tenure*' (*Financial Times* 10<sup>th</sup> April 2003) there were some interesting regional aspects.

Firstly there is a possibility that up to 20,000 public sector jobs (civil service, non-departmental bodies and other public services) could be transferred out of the south-east of England to the UK's regions and nations. The Chancellor has asked Sir Michael Lyons of Birmingham University to report to the government regarding relocation by the next spending review.

Secondly, is the prospect of regional pay variation for public sector workers. In order to aid decisions on regional pay, the Chancellor indicated that the ONS would start publishing regional inflation data. Thus far the ONS have resisted providing such data (except for one off studies such as that outlined in volume 14.1, p.9, of the Review). This development would provide valuable information for economic policy makers, who would, for example, be able to assess relative differences in GDP per capita, personal disposable income etc between areas in relation to regional price variations. However, there is likely to be strong opposition from those trade unions and others who are in favour of nationally agreed pay settlements.

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

	2003	2004	2005
Wales	1.2	1.5	2.0