Economic Commentary

World Economy

The Organisation for Economic Cooperation and Development (OECD) published their Economic Outlook interim assessment in March of this year. In that publication the OECD comments that the smooth economic expansion enjoyed by the OECD regions has been somewhat interrupted as a degree of global rebalancing is taking place. Total OECD area growth is forecast to fall to 2.5% in this year, compared with 3.2% in 2006. The United States is facing a slowdown in economic growth as inflation and labour market tensions put pressure on the economy, whilst the long boom in residential construction activity has recently halted. Housing starts have fallen by 33% from their peak in January 2006, and an estimated 7% of all American homeowners now face negative equity, where their house is worth less than their mortgage (The Economist, March 24 p.88). These housing market difficulties have yet to feed through to consumer spending, which is still relatively strong, however these problems may have negative impacts on the economy in the near future, depending on the scale and scope of any falls in house prices. In addition, as a consequence of its high energy intensity, the US economy has been hit particularly hard by past increases in oil and gas prices, which has shown through in headline inflation rates. Energy prices are now stabilising, and the mild slowdown in the US economy may restore price stability. According to the OECD, output growth in the US was 3.3% last year, and they forecast slower growth of 2.4% for this year, increasing to 2.7% in 2008 (see figure 1).

The Japanese economy is expanding, driven largely by business investment and strong export performances. Japanese industrial production grew by 4.3% in the year to January (The Economist, March 31), and economic growth in 2006 was 2.8% (OECD). However, household demand is relatively weak, wage growth is slow, and deflation has not yet disappeared from the Japanese economy. Recent data shows no change in Japanese consumer prices in the year to January, compared with a slight fall in prices (-0.1%) one year ago (The Economist, March 31). The OECD forecast Japanese economic growth of 2% for both this year and next.

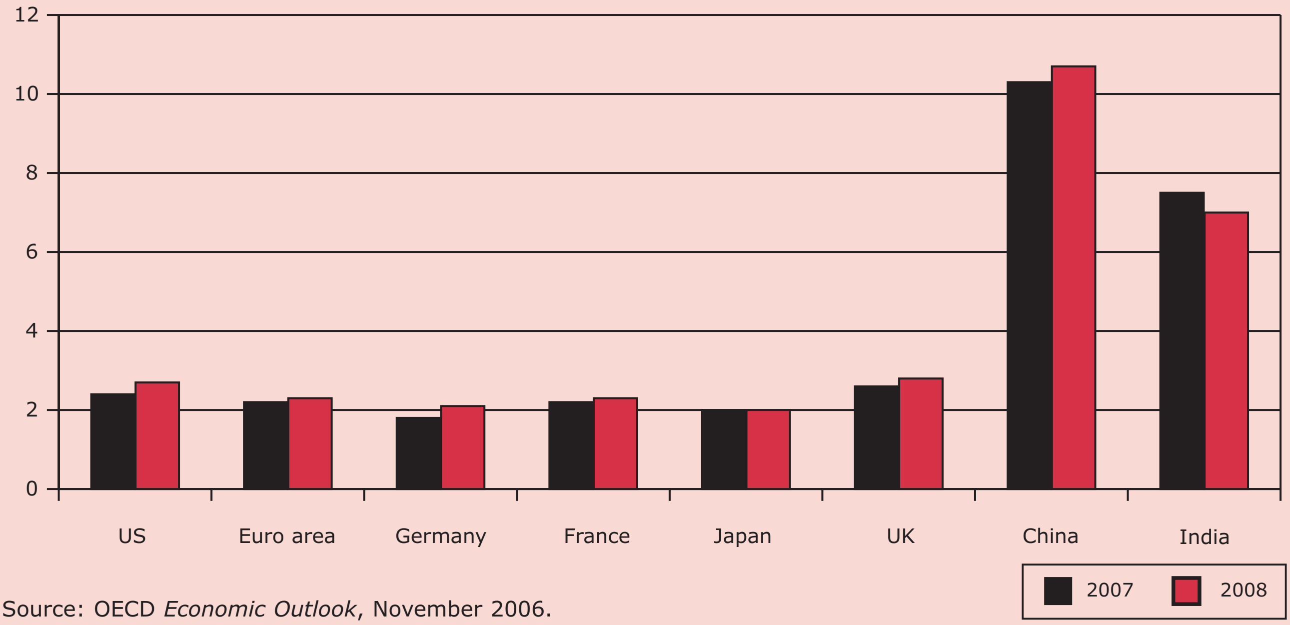
The rapid growth of the Chinese economy is set to continue to 2008. In 2006 the Chinese economy grew by 10.6% (OECD). Industrial production increased by a massive 14.7% in the year to December, slowing slightly to 12.6% in the year to February, although the unemployment rate for 2006 was 9.8% (The Economist, March 31). Real GDP growth is expected to be 10.3% this year, and 10.7% in 2007, and inflation is forecast to remain at around 2% (OECD).

The Indian economy, whilst also growing at a high level (8% last year, with an expected growth of 7.5% this year, and 7% in 2008, (OECD)) is however showing some signs of overheating. Inflation was 5% last year, with consumer prices increasing by 6.1% (OECD, note China and India are not part of the OECD area).

Economic activity has been relatively strong in the euro area in recent months. In the final quarter of 2006, economic growth was 3.3% (compared with 3.1% in the US). Germany has seen particularly strong recovery, with final quarter 2006 output growth of 3.7%, and with a 7.9% increase in industrial production in the year to January. German unemployment however still remains high, at 9.2% in March. This compares with a euro area average unemployment rate of 7.4% (January figure, all data from the Economist, March 31). At the start of the year the rate of value-added tax was increased in Germany, and this is likely to have some slowing impact on economic growth in Germany and the euro area more generally. The OECD expect German economic growth of 1.8% this year, increasing to 2.1% in 2008.

Economic growth in France was 2.1% in 2006. In the year to January industrial production fell by 0.6%, and the unemployment rate was 8.6% (The Economist, March 17). The OECD forecast French output growth of 2.2% this year, increasing to 2.3% in 2008.

Figure 1: Output Growth Forecasts, Selected Economies, Annual % Change, 2007 and 2008.



Source: OECD *Economic Outlook*, November 2006.

In a recent worldwide cost of living survey by the Economist Intelligence Unit, Paris was found to be the world's second most expensive city to live in, with Oslo the most expensive. London came third in this world ranking followed by Tokyo, Frankfurt and Hong Kong. Eight of the ten most expensive cities are in Europe. New York ranked 28th out of the 132 cities surveyed (summary results reported in The Economist, March 17 p.129).

The UK Economy

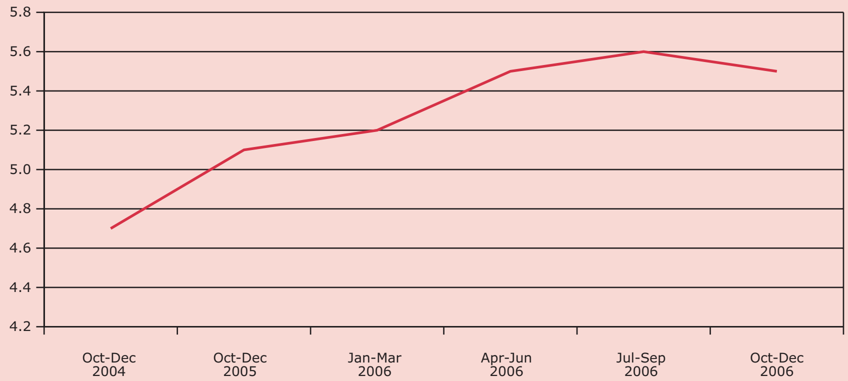
The UK economy grew by 2.6% in 2006, and the OECD expect similar growth this year, increasing slightly to 2.8% in 2008 (figure 1). The UK economy has been supported by strong domestic demand. The increasing labour force (resulting from immigration inflows, and increased participation) has not been matched by employment growth, hence the unemployment rate in the UK increased during 2006 (OECD). In the final quarter of 2006, the UK unemployment rate (ILO measure) was 5.5% (ONS, see figure 2).

The MPC decided to leave interest rates at 5.25% in their April meeting. The last movement was a quarter percent up in January 2007.

The UNCTAD World Investment Report 2006 shows that the UK had the highest levels of foreign Direct Investment (FDI) inflows in the world in 2005. FDI inflows to the UK increased sharply in 2005 to almost $165 billion. This compares with a European Union total of $422 billion, and inflows to the United States of $99 billion. However the UK FDI inflow in 2005 was dominated by a number of mergers and acquisitions. For example, approximately $74 billion of the UK FDI inflow was accounted for by the merger of Shell Transport and Trading with Royal Dutch Petroleum (Economic Indicators, November 2006, House of Commons Library). In contrast, in 2004, the US dominated FDI inflows, with UK inflows of only $56 billion.

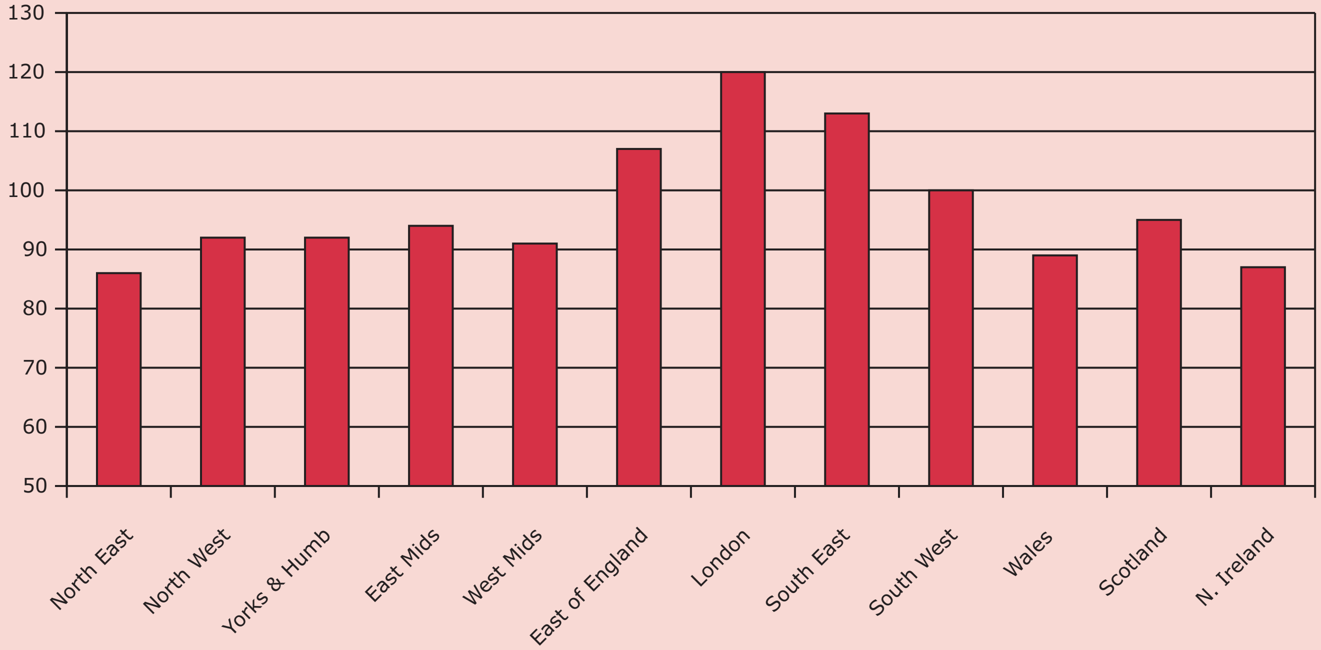
According to market development consultancy *Food from Britain*, British food and drink exports reached an all time high of £10.5bn in 2006. Their figures show four years of successive growth, and a widening portfolio of products. In addition they cite the return of British beef to overseas markets as part of the reason for this strong export performance. The EU accounted for £6.9bn of exports in 2006, with Ireland remaining the number one market for British food and drink, at almost £2bn, followed by France with £1.4bn of export sales. In terms of products, the drinks market increased by 7.4% during 2006, representing £3.7m of exports, with Whiskies accounting for £2.5bn of these sales. Exports of meat increased by 4% to £765m in 2006. Whilst lamb remains the largest seller, sales of beef have increased sharply in the last year and there is an expectation of continued growth in beef sales in future years (www.foodfrombritain.com).

Figure 2: Unemployment Rate %, All People Aged 16 and Over, UK, 2004-2006.



Source: Labour Force Survey

Figure 3: Regional Gross Disposable Household Income, Per Head Index, UK=100, 2005



Source: Office for National Statistics, Press Release, 27 March 2007.

The Welsh Economy

In March this year the Office for National Statistics published regional household income statistics for 2005. According to this data, average disposable income per head in Wales was £11,900 in 2005, this compares to an average £13,300 for the UK. Only Northern Ireland and the North East of England had lower average disposable incomes than Wales. In the West Wales and the Valleys (NUTS level 2) area, average disposable incomes were £11,630, compared with an average of £12,234 in East Wales. Disposable incomes in London and the South East of England were 20% and 13% respectively above the UK average in 2005 (see figure 3).

The Labour Markets section of this *Review* shows the unemployment rate for Wales to be below that of the UK (5.2% compared with 5.5%, ILO measure), but pockets of high unemployment remain in areas such a Blaenau Gwent and Merthyr Tydfil. Whilst the employment rates, and economic activity rates have increased over the year to January, these still lie below average UK figures. The Diary sections of recent *Reviews* have reported on many new company arrivals within Wales, which are contributing to the generally positive labour market outcomes mentioned above. However there have also been company closures, particularly in manufacturing sectors, with the prospect of further closures in the near future. The Industrial Activity section of this *Review* shows a worrying downward trend in the index of manufacturing output. This is significant for the Welsh economy, as manufacturing generally provides higher value-added employment compared with service sectors. Service sector growth may then have replaced and exceeded jobs lost by manufacturing industries although the value-added impact of these new jobs will be significantly less.

However, the Welsh Industrial Trends survey produced by the CBI for the first quarter of 2007 does allow a glimmer of hope, reporting the best rise in manufacturing orders since April 1995. The cause of this business optimism is linked to inflationary pressure in China which has made Chinese exports relatively more expensive, and hence Welsh and UK manufactured goods more cost competitive.

Table 1 shows forecasts for the Welsh economy for the period to 2009. The Welsh economy is expected to grow at a slower rate than the UK, at 1.5% for 2007 and 2008, increasing to 2% in 2009.

Table 1: Forecast Change in Real GVA (%).

	2007	2008	2009
Wales	1.5	1.5	2.0