



Prospects for the West Midlands Economy

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1 Background

This paper is our assessment of the short to medium term prospects for the West Midlands economy. The data used has been drawn from Cambridge Econometrics UK Multi-Sector Dynamic Model (MDM). This allows for regional forecasts to be generated for all 9 English regions and the devolved areas. For the local authority areas of the West Midlands the MDM regional forecast for the West Midlands is then fed into the Observatory's Integrated Policy Model. The Integrated Policy Model (IPM) is a new and sophisticated model developed by the Observatory. Further details are available on our website - [click here](#).

2 An uncertain future....

The causes of the current recession are very different from those of the last two, as are the macroeconomic measures introduced to deal with them. As the UK and the worldwide recessions worsen economists are reflecting on how the current recession compares with previous recessions. Whether the causes of the current recession are just a consequence of speculative and ultimately unsustainable trading of complex financial products or a natural hangover from a decade of growth funded through increased indebtedness by businesses, consumers and government, the outcome is still the same - a sharp and painful contraction in economic growth.

While output levels have fallen in previous recessions, often as a consequence of tighter monetary policy introduced to counter inflationary pressures built up during an upturn, traditionally banks have continued to provide short term financing. However, the difference between this recession and the last one is simply liquidity and confidence.

Figure 1: Historic and forecast real GVA growth - 1990-2018

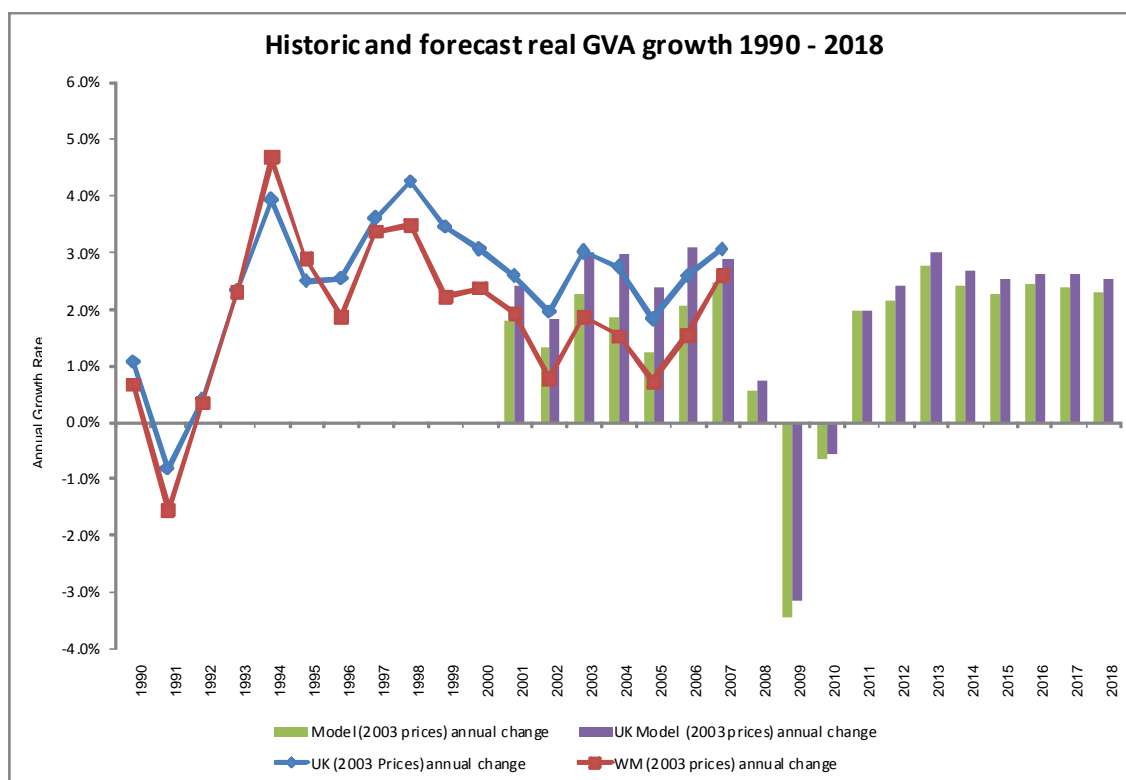


Figure 1 shows annual real GVA growth performance for the UK and West Midlands since 1990 and the forecast prospects to 2017. The graph clearly shows the speed and depth of the downturn, with 2008 growth falling in the West Midlands to only 0.5%. We forecast negative growth over the next two years, with the economy shrinking by 3.4% in 2009 alone.

The next section gives a more detailed discussion of the economic prospects nationally and in the West Midlands region.

3 Prospects for the UK economy

The recession in the UK is projected to be deeper and longer than was initially thought at the start of 2009 as official GDP growth figures were revised downwards. In the 12 months from June 2008 output is estimated to have fallen by 5.6%, the largest four-quarter fall since records began in 1956.

Our forecast indicates that the UK economy will contract in real terms by 3.2% in 2009 compared to 2008. The fall is the result of both lower levels of service and production output. A slowdown in the overall decline and a projected return to growth in the second half of 2010 will not be enough to prevent a further fall of 0.6% in output overall in 2010.

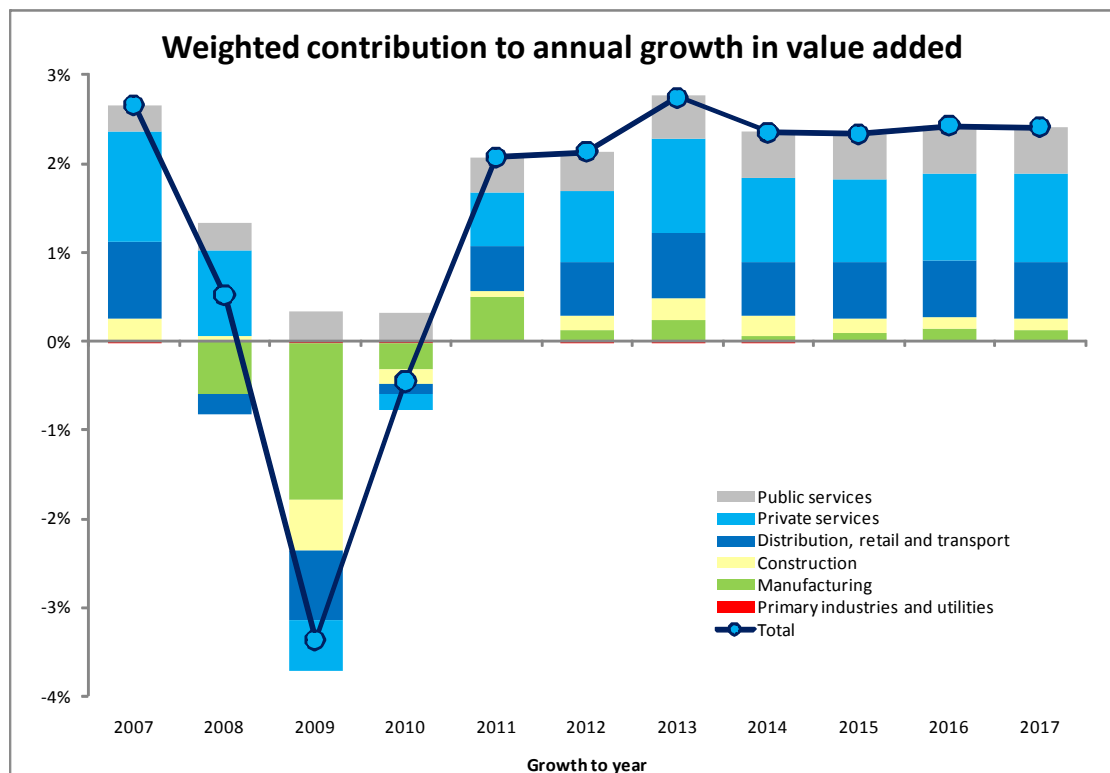
4 Economic prospects across English Regions

Modelled estimates¹ of the performances of the English regions indicate that the West Midlands economy weakened faster than a number of other regions in 2008. Output in 2008 is estimated to have grown by only 0.5% in real terms. The West Midlands regional growth rate was only above that of the East Midlands (0.3%) and Yorkshire and the Humber (0.4%) and level with the North West. Regions within the Greater South East (London, East of England and the South East) fared better with London estimated to have grown by 1.2% in 2008.

The recession is forecast to impact hard across all regions. There is little variation between the forecast falls in output in each of the regions in 2009. The regions which exhibited greater weakness in 2008 - East Midlands, Yorkshire and the Humber and West Midlands - are forecast to contract 3.6%, 3.5% and 3.4% in 2009. London, the South East and North East are forecast to contract by 3.3%. The South West is impacted the least in relative terms, with a fall in output of 2.5% for 2009 compared to 2008.

For the West Midlands this 3.4% fall is equivalent to nearly £3.5bn of lost output in 2008 prices or £2.7bn in 2003 prices.

Figure 2: Weighted contribution to annual growth in value added



¹ Official ONS provisional estimates for GVA are not published until December 2009

In terms of sectors the regional pictures mirror those nationally, although differences in the output shares of the key sectors will generate differences in the scale of the decline.

Manufacturing continues to be an important economic driver for the region. A sharp fall in manufacturing output in 2008 contributed to the initial slowdown and is the single biggest factor in driving growth downwards in 2009.

Whilst Figure 2 shows a decline in all sectors outside the public services, distribution and retail is a large sector in terms of its share of output so is another significant driver, with a forecast drop of 3% in sector output in 2009 contributing to nearly a third of the 2009 fall. The overall decline is further exacerbated by declines in private services and the poor economic prospects from construction.

Continued subdued activity in the first half of 2010 is expected to reduce the prospects for positive annual growth in 2010 before recovery starts more in 2011.

Manufacturing output is expected to pick up in 2011 and along with strong growth in financial and business services accompanying wider economic growth from other sectors. For the medium term however, projected stronger UK growth in financial and business services would suggest a return to UK output growing faster than the West Midlands region in the medium to long term resulting in further increases in the size of the output gap.

5 Employment prospects - background to employment in a recession

The received wisdom is that the labour market is a 'lagging indicator' in a recession. A fall in employment tends to follow a fall in output. The process is such that in the short term firms may reduce inventories in the face of a fall in demand. A fall in demand will initially impact on firms' sales and profits. If firms anticipate that the fall in demand is likely to persist they will seek to scale back production to reduce cost and boost profitability. In most sectors labour costs account for the largest share of total costs so a reduction in the workforce is often the next step.

So, a review of previous recessions will give us a guide to the likely effects on the labour market. The scale of potential job losses is difficult to judge by previous trends alone. The Bank of England Inflation report (August 2009), for example has compared the rate of employment losses over the first 5 quarters of recessions in the 1980s, 1990s and the current recession. The report suggests that the fall in employment has not been as marked as in previous recessions.

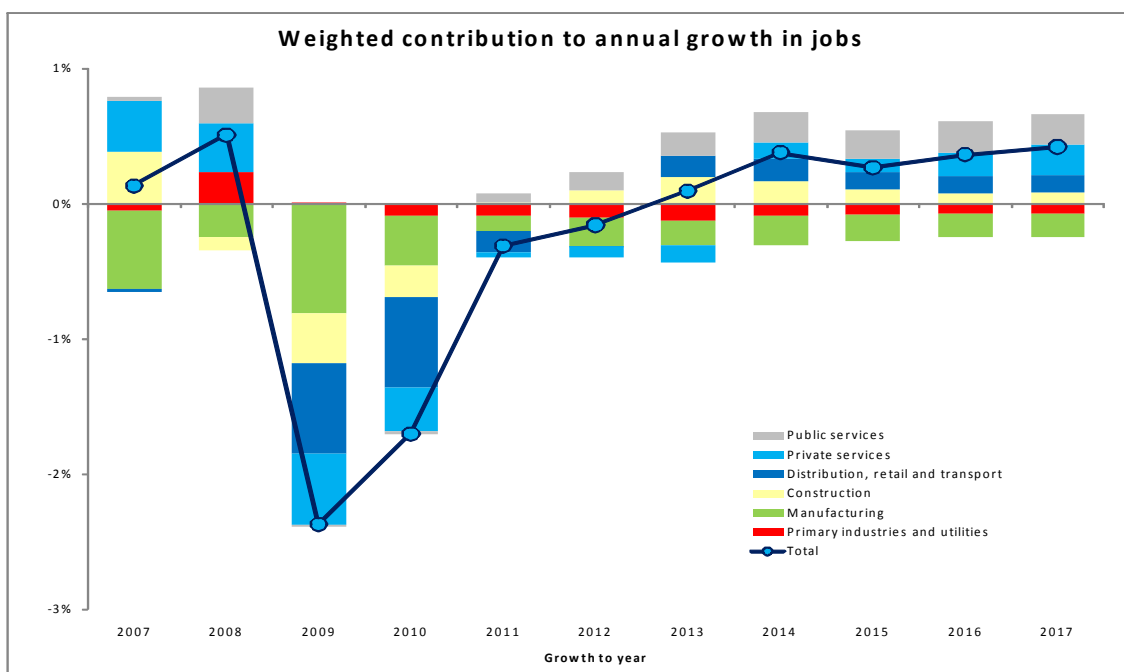
Latest estimates show that GDP has fallen by 5.7% in the last 5 quarters since the start of the recession compared to 4.7% in the 1980s and 2.5% in the 1990s. However, over the same period employment has fallen by only 1.7% in the current recession compared to 2.4% in the 1980s and 3.4% in the 1990s.

It is possible that greater flexibility in working practices and moderated pay growth, as employees seek job security over increased pay, may have dampened the expected fall in employment. However, the latest view from the Institute of Employment Studies² suggests that while increased flexibility may negate some of the employment pressures, an active public policy in meeting the challenges of unemployment may also be a key factor in the medium to long term.

6 Employment prospects for the West Midlands

Figure 3 shows how the recession is impacting on the key sector employment levels within the region.

Figure 3: Weighted sector contribution to annual growth in jobs



Comparison with figure 2 indicates that while the key sectors that are driving economic activity are the same, the scale of influence is different as employment shares differ from output. Employment tends to be evenly distributed so the impact of a particular sector is reduced.

² Institute of Employment Studies (2009) *Employment Studies no. 10 (July 2009)*

In 2009 we forecast a decline in employment of 64,000, a fall of nearly 2.5% on 2008 levels. Manufacturing is again the largest contributor to the overall decline in employment accounting for nearly a third of the overall fall when weighted by employment share. The sharp falls in manufacturing will be compounded by large falls in the increasingly important employment sectors of distribution and retail and private services (which includes financial and business services).

We forecast a potential loss of nearly 120,000 jobs regionally between 2008 and 2011. The differences in the prospects for sectors will shape the environment for the future employment prospects when the recovery is complete.

An emphasis on percentage change in sector employment can mask the impact on the regional economy overall as different sectors have different initial levels of employment.

Figure 4: Job losses by sector between 2008 and 2011

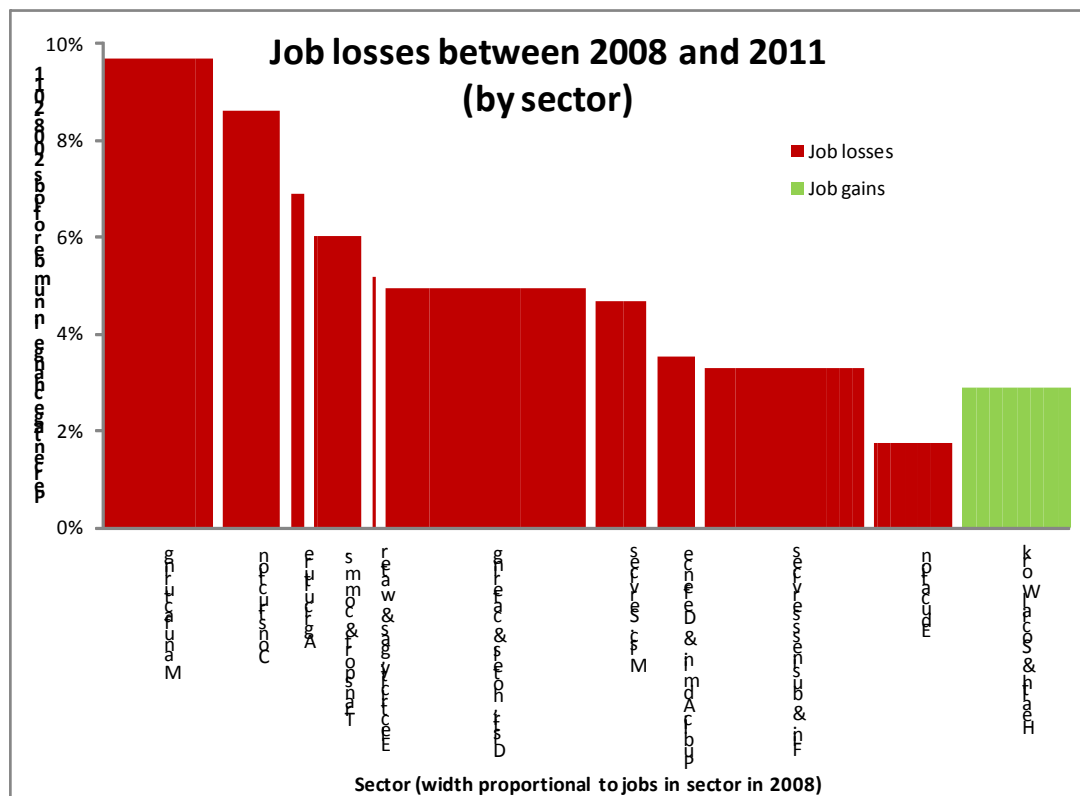


Figure 4 highlights the different sectors in terms of their share of employment in 2008 and the projected impacts of the recession.

The height of the columns represents the total job losses expected in each sector between 2008 and 2011 as a percentage of the 2008 employment in the sector. The width represents the total 2008 employment in each sector. The area of the column thus represents the total job losses/gains over the period.

The forecasts indicate that manufacturing will be hardest hit in percentage terms losing nearly 10% of jobs over the 3 years between 2008 and 2011. This translates to nearly 35,000 jobs. Construction is the sector next hardest hit in terms of percentage losses, with nearly 9% fewer jobs in 2011 than in 2008. In absolute terms this is over 15,500 jobs. However, distribution and retail, which had a larger share of total employment in 2008, could lose nearly 31,000 jobs or 5% of the sectors' 2008 employment.

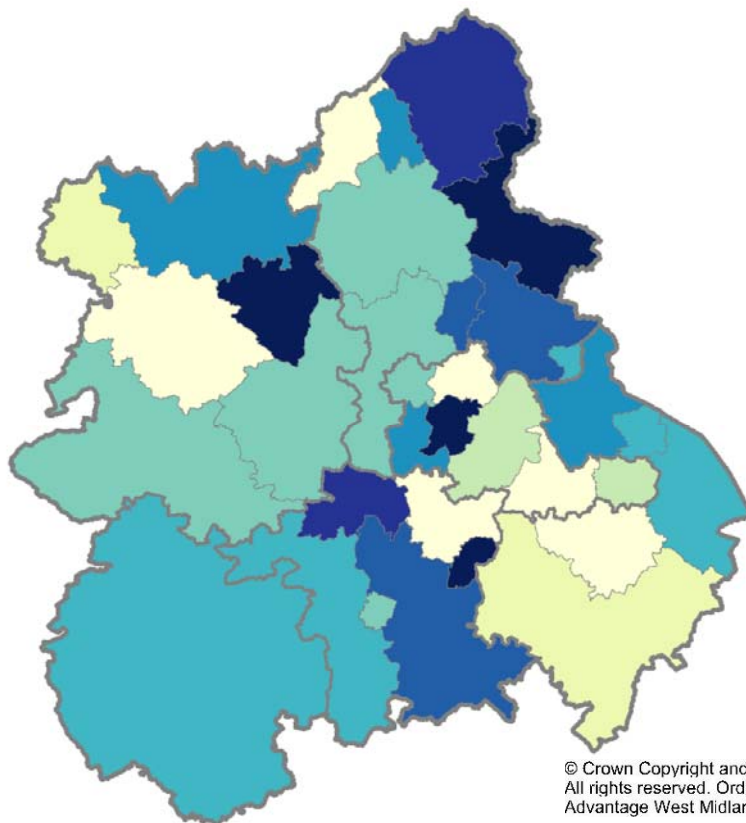
7 Sub regional impact of recession

The impact of the recession on key sectors can provide an indication of the geographical impacts within the region's local authority areas. While simple analytical techniques can be deployed in order to estimate the local impacts, this relies on some unrealistic assumptions notably that all areas are the same in terms of locations for sectors.

The following analysis is derived using the Observatory's Integrated Policy Model (IPM), a sophisticated economic model that has been developed to include the spatial relationships between local areas within the region and the incorporate the influence these have on the location decisions of firms within different sectors.

7.1 Manufacturing

Figure 5: Concentration of manufacturing employment by local authority



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Advantage West Midlands, September, 2009

Figure 5 highlights the areas within the region where manufacturing employment is most concentrated. The blue shading indicates areas where the share of employment in manufacturing is greater than the regional average. The darker the shade of blue the greater the relative share of total employment.

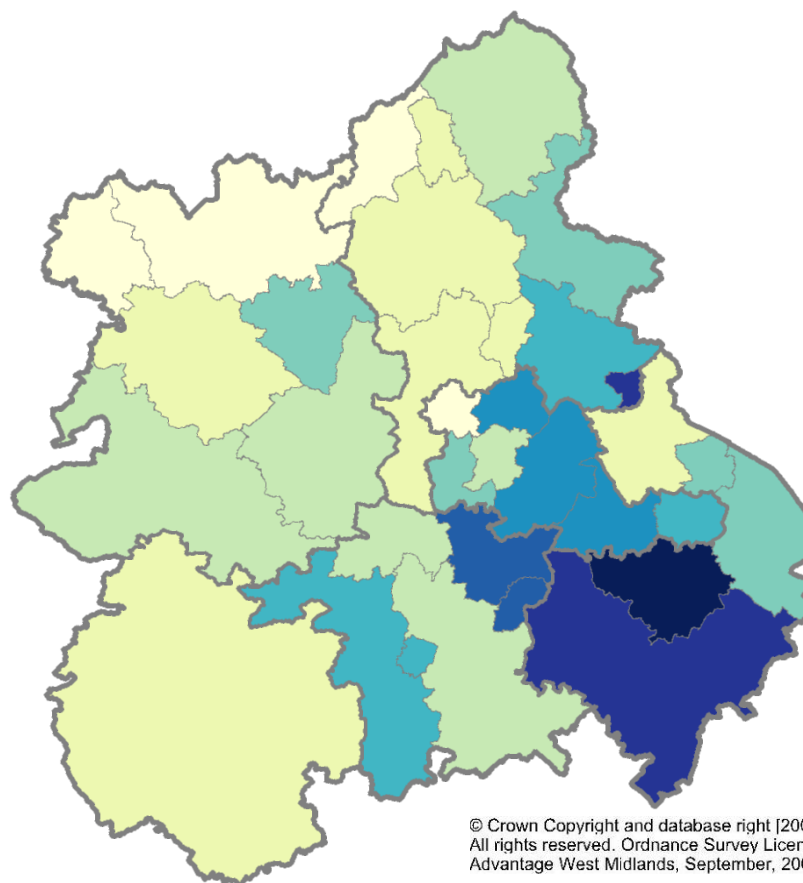
The four local authority areas where concentration in manufacturing employment is highest are Redditch, Sandwell, East Staffordshire, and Telford and Wrekin. These areas are forecast to be hit hard by the scale of expected falls in manufacturing employment.

Sandwell could be hit the hardest in terms of lost manufacturing employment. The borough could lose nearly 3,000 jobs in manufacturing, a fall of over 9% of the sector's employment base. This would account for over 8% of the West Midlands' manufacturing job losses over this period. Telford and Wrekin could see 1,600 manufacturing jobs lost a decline of 8.8%.

Redditch is forecast to lose 1,000 jobs in manufacturing between 2008 and 2011, an 8.7% decrease in the local sector employment and equivalent to 2.1% of all jobs in Redditch in 2008, while East Staffordshire lose nearly 1,000 jobs, a 7% decline.

8 Private services

Figure 6: Concentration of private services employment by local authority



Birmingham could see employment within the city fall by around 30,000 jobs between 2008 and 2011. The largest falls are expected in hotels and catering where we forecast over 5,000 jobs to be lost while professional and business services could see nearly 3,500 fewer jobs in 2011 than in 2008. Construction and retail are also badly affected and could see over 3,000 fewer jobs in each sector.

Sandwell is projected to see employment fall by the same 5.5%, which translates to around 8,000 jobs while Wolverhampton could see 7,000 jobs lost over the period.

The Shire counties of Warwickshire, Worcestershire and Staffordshire are also expected to see significant job losses over the period. Nearly 14,000 jobs could be lost in Staffordshire, particularly in hotel and catering where over 2,000 jobs could be lost. Construction could also be badly hit with a further 2,000 job losses in this sector and employment in land transport, which includes rail and air support services could see over 1,500 fewer jobs.

The recession impacts on construction and hotel and catering across the other Shires with Warwickshire forecast to lose nearly 1,800 jobs in hotels and catering and 1,700 in construction while Worcestershire could lose 1,400 in hotels and catering and a further 1,300 in construction.

9 Conclusion

The current recession is impacting hard on the national and regional economies. Hardest hit as is often the case in recessions are the manufacturing and construction sectors. Consumer services are also suffering with hotels and catering along with retail expected to see sharp falls in employment. Along with these sectors the impact is being felt through the professional services as well, with financial and business services being particularly badly hit.

The West Midlands, along with other regions is expected to see output levels contract by nearly 3.5% in 2009 with a likely prospect of negative annual growth in 2010. However, the forecasts are a reflection of economic conditions in the first quarter of 2009 and expensive fiscal and monetary policies have been implemented since including an unprecedented £175bn increase in the money supply.

With increased flexibility in working practices and restrained earnings growth the prospects for employment may not be as bad as initially expected. That said the recession will reduce the number of jobs across all sectors, including the public sector as fiscal constraints are imposed. Unemployment, particularly among the younger age bands will increase. With employment expected to continue falling even after output returns to positive growth, the likelihood of higher long term unemployment rates is a very real prospect.

Note of caution regarding forecasts....

In August 2007, just as the banking crisis was threatening to collapse the global financial system, economic forecasters using official data were predicting growth in 2008 of 2.3%. Six months later, as the impacts of the financial situation began to impinge on the real economy the prospects for 2008 were revised down to 1.8%, but commentators, aside from some dissenters were still forecasting growth in 2009 of 2%. A further 6 months later and a year since the full scale of the banking crisis was becoming known, and still many forecasters were projecting positive growth in 2009, albeit with a consensus that it would be below 1%. Three months later the majority of models were forecasting the recession that was going on around them but was just waiting for official confirmation.

In short there are a significant number of independent and official forecasts of the depth and duration of the current recession. Such is the uncertainty about global and national economic conditions that there are often revisions to central projections as new economic data becomes available.