

South West economic report

Executive summary

A weakening in household spending will underpin slower growth in the South West in 2008, with the regional economy likely to slightly underperform the UK average. Regional activity will pick-up again in 2009, in line with forecasts for the UK.

Key trends

- **The South West economy has performed strongly in recent years but growth will slow in 2008.** The increases in interest rates are expected to constrain spending by the heavily indebted consumer sector, resulting in a moderation in activity in the regional economy next year. We are forecasting growth of 1¾-2% in 2008. Activity will pick up in 2009, with growth edging up to 2¼-2½%, above the national average.

- **The unemployment rate is the lowest in Great Britain.** Growth in employment will continue at a modest pace over the next few years, with moderate job creation in private sector services partly offset by continued job losses in manufacturing. With retirees accounting for the majority of the recent population increase, the unemployment rate is likely to trend higher.

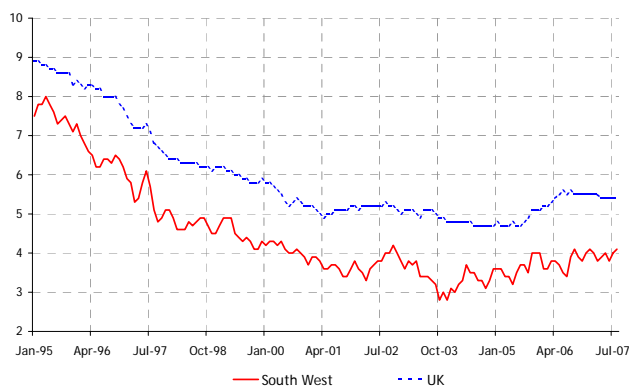
- **Housing market is cooling.** While the annual rate of increase in house prices in the South West remains robust, survey data points to a slowing in activity in the final months of 2007. We expect regional house prices to record little or no growth

over the next two years, with a risk that prices could fall slightly.

- **Household debt-to-income ratios are high.**

Data compiled by Experian shows that the average debt-to-income ratio in the South West will reach 2.2 times in 2007, above the UK average of 1.7 times. This increase in household debt largely reflects strong increases in house prices, with the average house price-to-income ratio for the South West forecast to reach 8.2 times in 2007, up from 5.4 times in 1990.

ILO unemployment rates - South West and UK (percent)



Regional growth slows in short term

The South West was one of the fastest growing regions in 2006, with the expansion in both services and manufacturing exceeding the UK average. While the regional economy started 2007 on a solid footing, growth in activity has moderated in the later half of the year, dragged down by a slowing in services activity. From 3.3% in 2006, we expect growth in the South West to slow to 2¾-3% in 2007, broadly in line with or just below the UK average.

In 2008, weaker growth in household spending is expected to constrain growth both regionally and nationally. A high household debt burden in the South West is expected to constrain growth in household spending and in turn private sector services next year. The labour market is expected to remain robust, with the unemployment rate remaining one of the lowest across the UK. The pace of house price growth is forecast to slow further in 2008, with only little or no growth expected in prices.

In 2009, activity in the South West will gradually gather pace and is forecast to slightly outperform the UK average. Growth in private sector services and manufacturing will pick-up, underpinning moderate growth in employment. Growth in consumer spending will remain constrained by relatively high levels of debt. Average house prices are forecast to remain largely unchanged.

GVA growth, South West and UK (percent)

	South West	UK
2006	3.3	2.8
2007 (f)	2¾-3	3.0
2008 (f)	1¾-2	1.9
2009 (f)	2¼-2½	2.2

Regional & sub-regional characteristics

The South West economy has its own characteristics that differentiate it from other UK regions. The South West is under represented in private services but has an above average public sector. That said, the regional economy has a successful tourism industry, which has underpinned solid growth in Distribution, hotels and catering. Agriculture in the south West is twice the UK average. The South West also has a greater share of manufacturing than the UK average, dominated by a high-tech Engineering sector.

The South West is characterised by wide intra-regional differences in output. The northern part of the South West region is the main economic engine of growth while some south and south-western areas, on the other hand, particularly rural areas, have recorded weaker performances in recent years. The fastest growing sub-regions between 2000-2004 were recorded in the commuter belt areas of Gloucestershire, and North and North East Somerset, partly reflecting the proximity and influence of Bristol. In 2005, however, growth in these sub-regions moderated. Swindon has slowed significantly in recent years, partly reflecting the global pressures exerted following the busting of the "dot com" boom in the early 2000s. That said, more recently Swindon

has showed signs of a recovery. Some of the historically under performing sub-regions are now recording fast rates of growth, including Cornwall and the Isles of Scilly. Torbay, in contrast, experienced significant losses in manufacturing capacity and weaker tourism, leading to a slowing in growth in the late 1990s/early 2000s before picking up again since 2003.

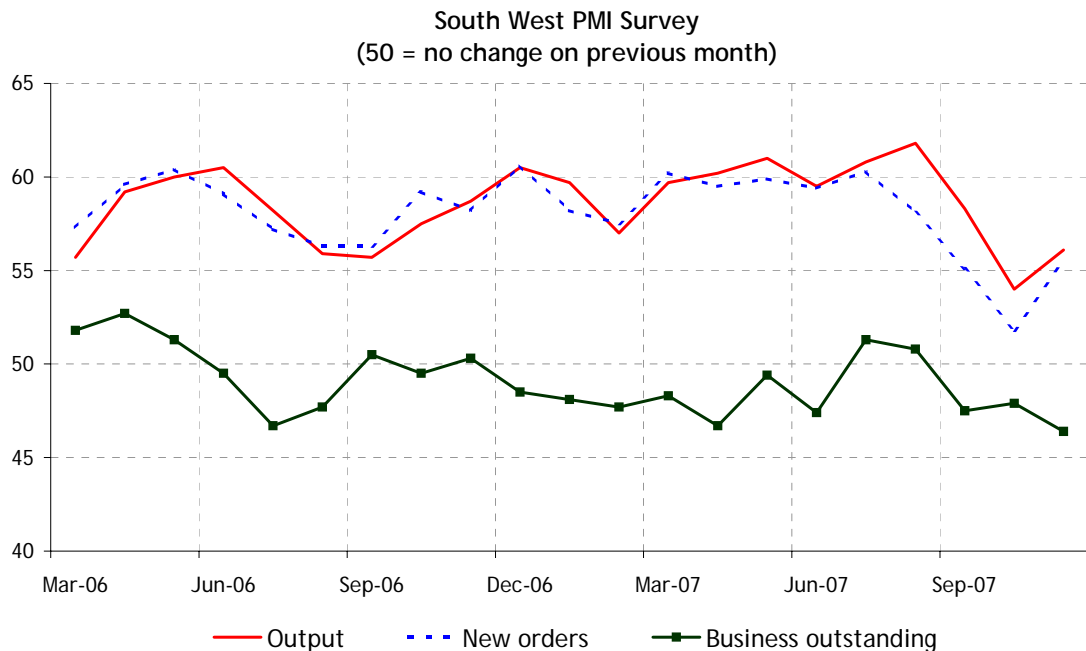
Private sector growth slows in Q4 2007

Results from recent South West PMI Report indicate that the South West’s private sector has lost momentum in the December 2007 quarter. While output continued to expand, the rate of growth had slipped to its lowest rate in over a year. That said the South West remained one of the strongest performing UK regions. In the three months to November 2007, regional growth in private sector output exceeded the UK average.

An easing in regional new order growth has accompanied this slowdown in activity, with growth in new business volumes dipping to levels not seen since 2005. The level of business outstanding also declined, in keeping with conditions across the wider UK economy. While firms in the South West continued to recruit additional staff, the rate of increase in employment had eased. Higher prices for oil and raw materials pushed up input prices to their fastest rate of growth in over a year. Prices charged by firms had also risen, reaching their highest rate of growth since the beginning of the year.

Job creation continues at modest rate

Despite a modest pick-up in the unemployment rate from its record lows, the South West labour market remained robust in 2007. The creation of new jobs in the South West economy continued to be largely confined to services, in particular Real estate and



Business activities, and Hotels & Restaurants. Employment in manufacturing and construction, on the other hand, trended down. In the three months to September 2007, employment growth was up by 1.6% on year earlier levels.

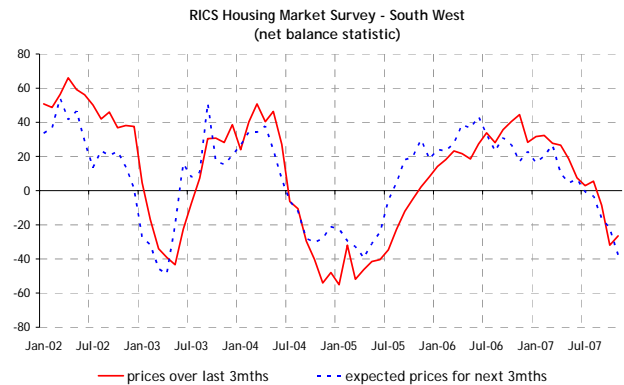
The rate of increase in migration into the region, however, has outpaced jobs growth, leading to an increase in the unemployment rate. That said, the unemployment rate is the lowest in Great Britain. In the three months to September 2007, the ILO unemployment rate stood at 4.1%, up from its record low of 3.2% in mid-2005 and well below the UK average of 5.4% in the three months to September 2007.

House price inflation now easing

After peaking in late 2006, price inflation in the South West housing market has eased in 2007 as the five increases in interest rates since last summer have dampened housing demand. From 11.9% yoy in December 2006, annual growth in regional house prices had eased to 8.8% by September 2007. This is broadly in-line with average conditions across the UK. Annual UK house prices inflation has eased from 12.4% yoy in March 2007 to 8.4% yoy in September 2007.

The RICS Housing Market Survey indicates that sentiment in the housing market has slipped during the final quarter of 2007. Survey results indicate that house prices fell in the three months to November. Confidence in the price outlook also declined, with a fall in expected prices for the next 3 months. On the

demand side, new buyer enquiries continued to decline, while on the supply side, new vendor instructions also fell.



Recent Rightmove survey results also point to a weakening in the South West housing market, with house prices up by a modest 4.5% on year earlier levels in December 2007. Consistent with the results from the RICS Housing Market Survey, house prices fell on a month on month basis in November and December.

We expect growth in South West house prices to gradually ease over coming months, with little or no growth expected in 2008 and 2009. With the house price-to-income ratio at historically high levels, there is a risk that house prices could fall slightly over the next two years.

Household debt burdens trend higher

Average house prices in the South West, at £239,489, are higher than the UK average of £232,033. Housing affordability remains a problem in the South West with the region having one of the highest house price-to-income ratios, only just behind the South East. Experian estimates that the average house-price to

income ratio in the South West will be 8.2 times in 2007, compared with 6.2 times for the UK and 8.3 times for the South East.

The boom in house prices in recent years has underpinned an explosion in household debt in the South West. Experian estimates that the average household debt-to-income ratio in the South West will reach 2.2 times in 2007, compared with 1.7 times in the UK and 2.4 times in the South East.

High levels of household debt, combined with the five cumulative increases in interest rates since August 2006, are expected to constrain growth in household spending in the South West over the next couple of years.

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