

Economic Commentary

World Economy

The International Monetary Fund (IMF) recently published its latest *World Economic Outlook* (September). According to the IMF 'the global recovery has become increasingly well established, with global GDP growth now projected to average 5% in 2004, the highest for nearly three decades'. The previous IMF forecast was for global growth of around 4.5%. The latest *World Economic Outlook* does, however, note several points of caution. For example, the pace of economic growth has slowed slightly in the United States, Japan and China, with spill-over implications for other world economies. Moreover, high oil prices are still a cause of concern. America and China have together accounted for almost half of world growth over the past year. In addition the IMF comments on a possible collapse in global house prices and a slowdown in consumer spending in the US. In China, a slowdown in economic growth may be welcomed given previous worries of an over-heating economy. There are hopes that this may be a soft rather than hard landing for China, as there could otherwise be serious implications for the rest of Asia, and for global confidence.

Figure 1 shows the IMF's forecasts for world output in selected economies for 2004 and 2005. The US economy is expected to grow by 4.3% this year and by 3.5% in 2005. Growth projections are lower for 2005 than for 2004 for most economies. High oil prices and sluggish employment growth have contributed to a slowing of consumer spending in the US. This spending has been financed heavily by borrowings on assets. Also, whilst US interest rates remain low, these have now started to rise, moderating house price inflation and further suppressing consumer spending. However on the positive side, US business sectors are reporting high levels of confidence, investment and labour productivity.

As noted earlier, China has made a significant contribution to recent world economic growth, and output growth continues to exceed expectations. The IMF forecast is for a 9% growth in the Chinese economy this year, and 7.5%

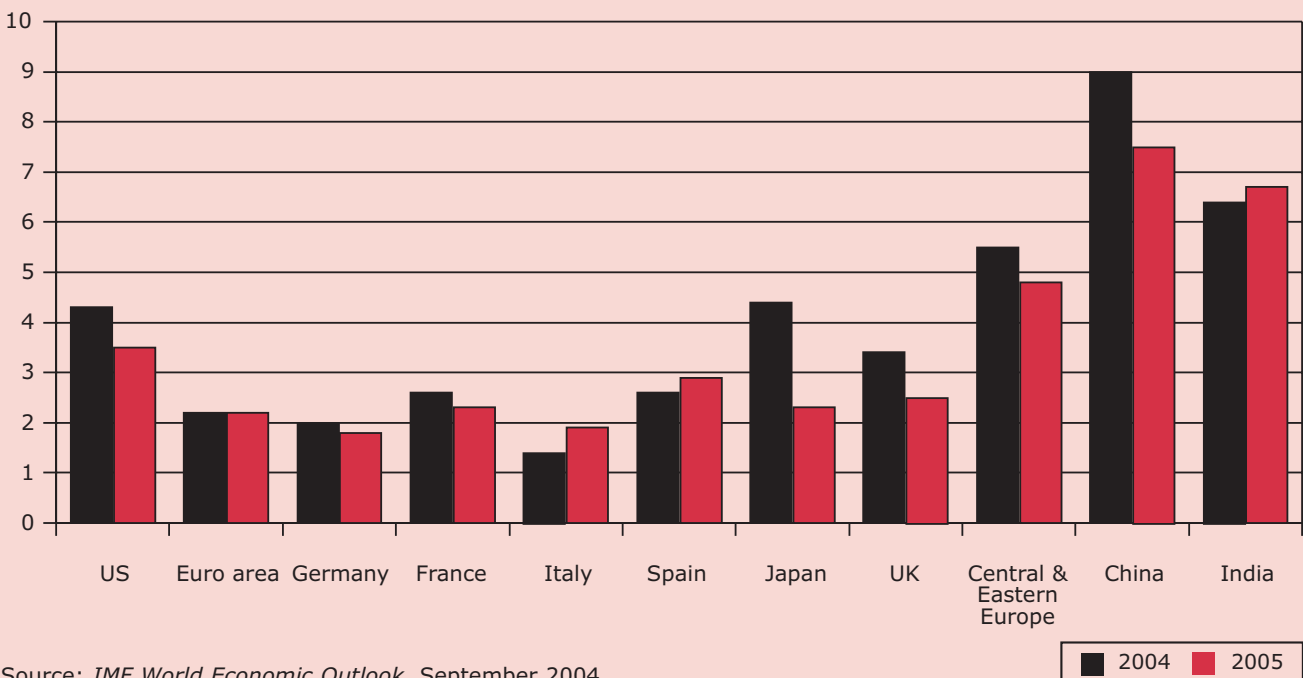
growth next year. China is reported to be the 'new workshop of the world', as it now produces two-thirds of all photocopiers, microwave ovens, DVD players and shoes, over half of all digital cameras and around two-fifths of personal computers. China is also the world's largest consumer of steel, copper, coal and cement, (*Economist*, October 2nd). China is the largest world recipient of foreign direct investment, a consequence of low labour costs, and the draw of the huge domestic market. The recent economic growth in China is linked to high rates of investment, and to the movement of workers away from low productivity agriculture into industry. In addition, China has a well educated workforce and an improving infrastructure. However this economic growth is placing heavy demands on world energy and raw material supplies, with consequences for world prices, including that of oil.

Prospects in the Japanese economy

have been partly linked to those of China, and the growth forecast for this year is 4.4%, falling to 2.3% next year (Figure 1). Exports to Asia and business investments have contributed to Japan's economic growth, as has the increase in consumer confidence and labour market conditions. There are risks for Japan, as elsewhere, associated with higher oil prices and a potential slowdown in trade. Japan is also continuing to experience deflation. Consumer prices fell by 0.2% in the year to August, a marginal improvement on the larger fall of the previous year. The IMF has, however, suggested that prospects for an end to deflation have improved.

Economic growth in the euro area is expected to rise to 2.2% this year, and to remain at similar levels in 2005 (see Figure 1). The *Economist* Poll (October 9th) is, however, slightly less optimistic with forecasts averaging 1.9% for this year and next. The upturn, whilst moderate, has been largely due to

Figure 1: World Output (annual % change), Selected Economies, 2004 and 2005.



Source: IMF World Economic Outlook, September 2004.

external demand, and with industrial production and business confidence showing signs of improvement. However, this growth has failed to reduce unemployment, which averaged 9% in August of this year, compared with 8.9% the previous year. The economic fortunes of countries within the Euro area continue to vary. In Germany the numbers of unemployed grew by 27,000 in September; much more than had been expected, and with the unemployment rate rising to 10.7%.

Global House Prices

As noted above, the IMF has warned policymakers to be aware of the potential consequences of depressed house prices. In September the *Economist* published its global house price index, and the results for selected countries are shown in Figure 2. Hong Kong has experienced a remarkable turnaround in house prices, now topping the league, with an average gain of 28.7% in the year to the second quarter. Hong Kong is closely followed by South Africa and New Zealand, which have both experienced gains of over 20% during the past year. Euro area countries have again varied in this respect, with strong house price growth in Spain, France, Ireland and Italy, compared to falling prices in Germany. Although the index for Britain was lower in the latest period compared with 2003, Britain still remains towards the top of the house price index league. According to data published by the Office of the Deputy Prime Minister, prices rose in Britain by almost 14% in the year to July, compared to a figure of around 25% at the end of 2002. The Property Markets section of this *Review* provides further house price commentary.

According to the *Economist*, house prices are at record levels in relation to average incomes in many countries, including the US, Britain, France and Ireland. Even if house prices just level-off the *Economist* suggests this could trigger a sharp slowdown in consumer spending.

The UK Economy

The economic growth forecast for the UK economy this year is 3.4% falling to 2.5% in 2005 (Figure 1). Strong levels of economic activity are linked to rising housing wealth, investment and increasing levels of public expenditure. As noted by the house price index in Figure 2, house prices have slowed recently, but still remain high. Interest rates have increased five times since November 2003, and in October stood at 4.75%. The interest rate increases have been aimed at keeping inflation within target levels over the medium term. Significant further increases in the

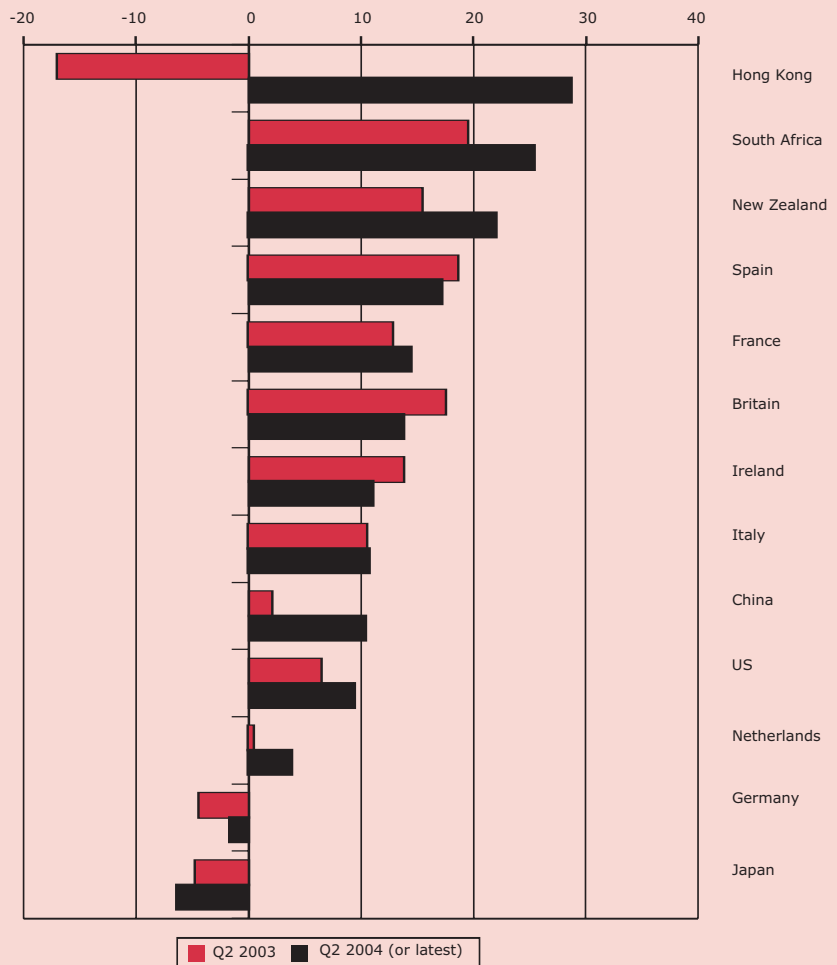
coming months are unlikely. The fragile manufacturing sector, the recent rise in oil prices, and interest rate increases are all likely to have a dampening effect on the economy.

In July, the Chancellor announced his public sector spending plans. As part of these plans the National Health Service's (NHS) budget is to rise by an annual rate of 7% in the two budgetary years to 2007-8, with the education department receiving a 3.5% annual increase. Other departments are less fortunate, with budget rises of only 1.5%. However, part of these plans involves a series of 'efficiency savings', which will result in public sector job losses. The civil service is set to lose over 70,000 posts (after allowing for redeployment), whilst further savings will be made by relocating 10,000 public sector jobs out of London and the South East of England to the regions.

The UK unemployment rate (ILO measure) was 4.7% in July, falling from 5.1% the previous year. During

September there was mixed employment news for the UK motor industry. After weeks of speculation Jaguar's Coventry headquarters revealed that the production of its most prestigious models would be transferred to Birmingham. Whilst this secured jobs in Birmingham, hundreds of jobs are to be lost in Coventry, although some workers will be retained. However, despite such problems, the output of Britain's car industry is reported to be on track to reach the record levels of 1972. This is at a time when car production in other European countries (such as France, Germany and Italy) is faltering, as production moves to central European nations (*Economist*, September 11th). The *Economist* credits Britain's success to its having the world's most international car industry producing nine 'volume brands', compared to Germany, for example, which has just six. As part of this internationalisation, the revival in the fortunes of Britain's car industry has been led by the Japanese, and the Nissan factory in Sunderland is still

Figure 2: Global House Price Index (% change on a year earlier). Selected Countries.



Source: The Economist, September 11th 2004, p.85.

reported to be the most efficient in Europe.

The Welsh Economy

Data from the Labour Force Survey (LFS) showed that in the period June to August 2004 there was a fall of 26,000 in the number of economically active people compared with the March to May period. This fall pushed the economic activity rate down in June – August. This fall is a consequence of changes to the total number of people in employment, as numbers unemployed have varied only marginally. The (ILO) unemployment rate remained at 4.6% in the June-August period, representing around 63,000 people.

As in the UK, and indeed the world economy, one of the main economic stories continues to be that of house

prices. Average house price inflation in Wales is now above that of the UK, and some parts of Wales are now experiencing higher price levels than those of the average UK house. The Property Markets section of this *Review* shows that the highest Welsh house prices are found in Powys and South Glamorgan.

The Industrial Activity section of this *Review* comments on recent trends in the manufacturing sector of the economy. At the end of the first half of 2004, the Welsh index of manufacturing output was round 2% below its 2001 levels. Whilst it is always difficult to predict future changes, there is some confidence reported in recent business surveys. During the summer, respondents to the South Wales Chambers Group survey reported a rise

in employment and investment expectations. However threats to future manufacturing output remain, particularly those from central and eastern European competitor economies.

Forecasts

Table 1 shows forecasts for the Welsh economy for the period 2004-2006. These forecasts are unchanged from those given in the previous *Review*. The Welsh economy is expected to have grown by 2.2% this year, and with forecast growth of 2.0% in both 2005 and 2006.

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

	2004	2005	2006
Wales	2.2	2.0	2.0