

# Economic Commentary

## World Economy

World economic growth was strong during 2005. Whilst economic growth in the United States slowed in the last quarter of 2005, the US economy has been relatively resilient against the impacts of the hurricanes and problems in energy supplies. Growth in Asian economies has also been maintained with economic growth in the Japanese economy now appearing to be well established. The economic signals coming from continental Europe are however mixed, with output still below potential levels. Importantly, most

countries have been able to maintain underlying price and wage stability despite the recent high fuel prices.

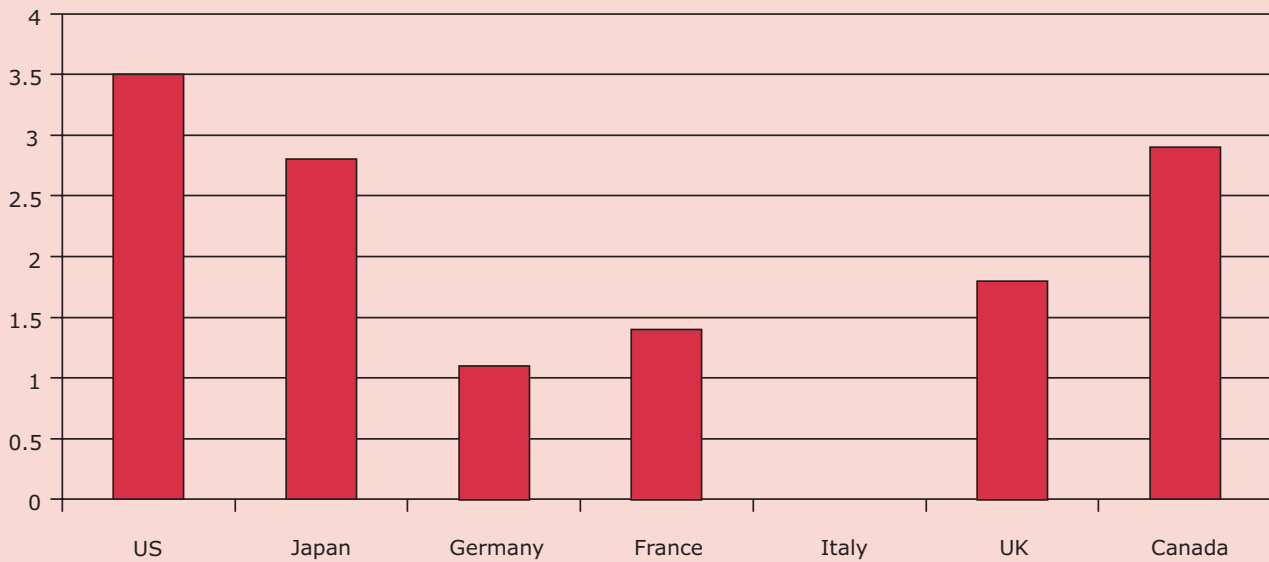
The Organisation for Economic Cooperation and Development (OECD) published an interim assessment of the economic outlook for OECD countries in March of this year. This report provided average GDP growth figures for the G7 economies in 2005, shown in figure 1.

The average growth rate for the G7 economies in 2005 was 2.6%. Figure 1 shows the stronger than average

performance of the US economy, which grew by 3.5%, the Japanese economy, which grew by 2.8% and the Canadian economy, with a growth rate of 2.9%.

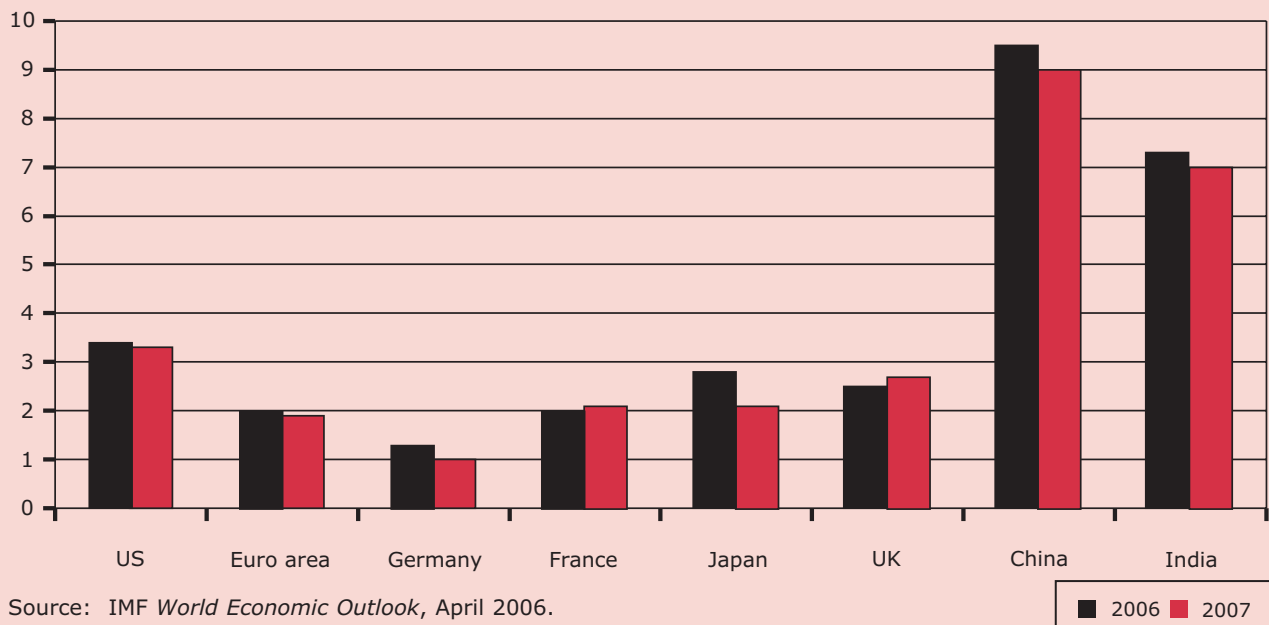
The *Economic Outlook* published by the OECD at the end of last year indicated that a prolonged world economic expansion was plausible, given the spillover impacts arising from growth in the US and Asian economies, and despite risks to global growth, including another surge in oil prices. This general optimism was echoed by the International Monetary Fund's (IMF)

**Figure 1: GDP Growth in the G7 Economies, 2005, year averages, %.**



Source: OECD *Economic Outlook*, Interim Assessment, March 2006.

**Figure 2: Output Growth Forecasts, Selected Economies, Annual % Change, 2006 and 2007.**



Source: IMF *World Economic Outlook*, April 2006.

*World Economic Outlook* (April 2006) which predicts world output growth of 4.9% this year and 4.7% in 2007.

Figure 2 shows the IMF's output growth forecasts for selected economies for 2006 and 2007. The US economy is expected to grow by over 3% this year. Industrial production and retail sales growth were both strong in the opening months of 2006 (up by 3.3% and 5.1% respectively in February when compared with one year ago), whilst the unemployment rate for February was 4.8% compared with 5.4% at the same time last year. The Federal Reserve have, nevertheless, commented that the short term prospects for the economy are largely dependant on the housing market, and its impacts on consumer spending (*Economist*, April 1<sup>st</sup> 2006). Sales of newly built houses fell sharply in February, while there was some recovery in the market for existing houses. Thus far, the Conference Board's index of consumer confidence has remained strong, and jumped to a four year high in March.

The Japanese economy is also expected to grow strongly in 2006. Figure 2 shows growth forecasts of 2.8% this year and 2.1% in 2007. Consumer and producer prices are now increasing in Japan. Consumer prices increased by 0.5% in February; this compares with a 0.3% fall in prices one year previously. The unemployment rate in Japan fell to 4.1% in February; its lowest since 1998.

Economic growth continues apace in both the Chinese and Indian economies. In China industrial production in February increased by a staggering 16.2% compared with the previous year.

In recent years (since 2000) China's impact on global GDP growth has exceeded that of America, and has been more than half as big again as the combined contributions of India, Brazil and Russia (*Economist Survey*, March 25<sup>th</sup> p.3). Past performance does not guarantee the future of the Chinese economy, and such strong growth may be difficult to sustain. One concern relates to the growing income inequalities (between rural and urban communities), and the potential instabilities and political upheaval that could result.

Figure 1 shows the below G7 average growth performance of France, Germany and Italy in 2005, with the Italian economy giving an official estimate of 0% growth for 2005. The average growth rate for the whole Euro area in 2005 was 1.1%. Figure 2 shows that prospects are better for this year and next, with the IMF predicting output growth of 2.0% and 1.9% respectively. The OECDs Interim Assessment (March 2006) commented that for the Euro area "hard indicators continue to paint a distinctly weaker picture than the softer but more forward-looking survey information." They noted that this was particularly evident in the three largest economies, especially Germany.

**The UK Economy**

The UK economy grew by 1.8% in 2005 (Figure 1), and is expected to grow by over 2% in both this year and next (Figure 2). Weaker consumption relating to the housing market was partly responsible for the relatively slow growth rate in 2005 (this was the lowest growth rate since 1992), however stronger investment and export

performance is expected to increase growth rates above 2% during the next two years (*OECD Economic Outlook*, December 2005). However, whilst retail sales were up by 2.1% in February, compared to one year previous, industrial production fell by 1.4% over the same period, and the ILO unemployment rate for January was 5%, compared with 4.7% in January 2005.

Prospects for the UK economy are closely linked with household spending, which accounts for over 60% of GDP. Since 1995 consumer spending growth has outstripped GDP growth, as people have been saving less. With the housing market slowing, levels of household debt rising, and higher energy prices stretching household budgets, the growth in consumption is likely to be restrained in the near future. In addition, the growth of public sector spending will slow to around 3% a year (down from the 4.9% of the previous 6 years), and from 2008 the Chancellor indicated that this would be cut further, to just 1.9% (*Economist*, March 25<sup>th</sup> p.35). As indicated by the OECD, UK economic growth will then have to come from other sources. These sources include business investment and trade, both of which will need to pickup if the forecasted growth of the next two years is to be achieved.

**The Welsh Economy**

In December 2005 the Office for National Statistics published provisional estimates of regional gross value added (GVA) for 2004. This data showed that GVA per head in Wales, at £13,300, was some 21% below the UK average, the lowest of all UK regions (see Figure 3).

**Figure 3: Regional GVA, 2004, UK=100.**



Source: Office for National Statistics, 21 December 2005, provisional estimates.

Northern Ireland and the North East of England had GVA per head figures marginally above that of Wales (at £13,500 and £13,400 respectively).

Figure 3 then shows Wales to be at the bottom of the regional prosperity league. This is particularly disappointing given the efforts of various programmes and initiatives (not least the European Union structural funding programmes). Whilst this data relates to the Welsh economy some two years ago, the more recent economic data is also not encouraging. The Welsh labour market

had been performing relatively well. However, the Labour Markets section of this *Review* now suggests there may be cause for concern, with the latest data from the Office of National Statistics indicating falling employment rates and an increase in unemployment in Wales. At the same time, levels of industrial output in Wales are declining. By the end of 2005, industrial output was some 9% below levels recorded in 2002 (see Industrial Production section of this *Review*).

**Forecasts**

Table 1 shows forecasts for the Welsh economy for the period 2005 -2007. These forecasts are unchanged from those presented in the Autumn 2005 *Review*. The recently published GVA statistics for 2004 (see above), together with increasing unemployment rates and falling levels of industrial activity continue to signal slow growth for the Welsh economy in the near future.

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

	<b>2005</b>	<b>2006</b>	<b>2007</b>
Wales	0.9	1.2	1.2