Economic Commentary

World Economy
In October 2009 the International Monetary Fund (IMF) published its latest *World Economic Outlook*. That publication is sub-titled '*Sustaining the Recovery*' and the foreword begins by stating that '*the recovery has started, and the challenge is to sustain it*' whilst the executive summary notes that '*global recession is ending, but a subdued recovery lies ahead*'. In all, economic commentators are expecting a return to positive economic growth in most of the major world economies in 2010. The IMF revised its forecast for next year's global GDP growth upwards to 3.1%.

Output in the 'advanced economies' is expected to have fallen by an average of 3.4% in 2009. These countries (including for example, the United States, Euro area countries, Japan, and Canada) were affected particularly badly by the financial crisis and falling levels of world trade. The IMF expect outputs of the advanced economies to increase by an average of 1.3% in 2010, although there is considerable variation in expectations for different countries. For example the US economy is expected to grow by 1.5% in 2010, and the UK economy by 0.9%, whilst the IMF is forecasting that countries such as Spain, Greece and Ireland will remain in recession during 2010 (See figure 1).

The IMF report and others suggest a slow recovery, and that '*the world economy is far from returning to 'normal' activity*' (Economist, October 3rd). Economic growth levels are not expected to be sufficiently high to reduce unemployment, indeed for many economies the forecast is for unemployment to increase still further in 2010 (Figure 2), whilst latest figures show industrial production in most countries (with the exception of China and India, see later) to be falling, although with expectations of a pick-up in activity.

In response to the global downturn interest rates were cut, measures were adopted to inject liquidity and sustain credit, and fiscal stimulus programmes were undertaken. These forces, which will partly contribute to the upturn next year, will however ease in the coming years.

As is evident from Figure 1, China and India escaped recession, reportedly the result of a large policy stimulus, and in India's case, reduced dependence on exports. Industrial production in China grew by 16.1% in the year to October, and in India growth in industrial production was 9.1% in the year to September 2009.

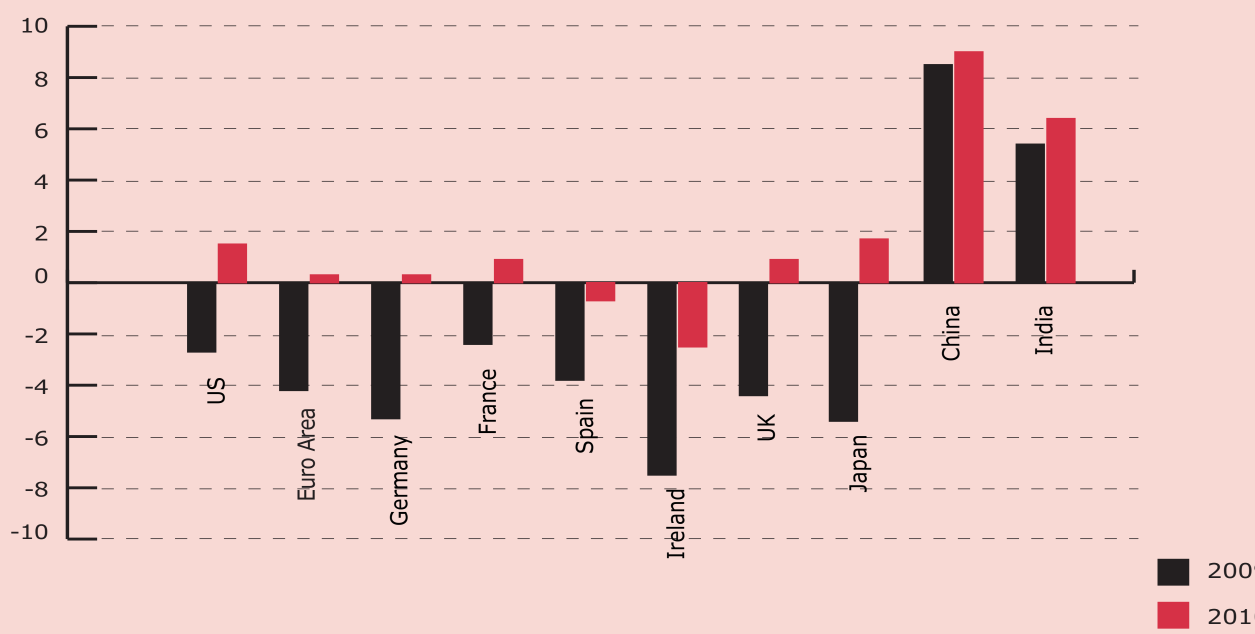
China has recently overtaken the United States as the world's biggest carbon emitter, and these two countries together account for 40% of the world's carbon dioxide emissions (Economist, October 24th). Around 70% of China's electricity supply comes from coal-fired power stations, with coal supply both plentiful and cheap. There are hopes that agreements can be made by these and other world economies at the next UN climate change conference in Copenhagen in December 2009.

Foreign Direct Investment (FDI)
In September the United Nations Conference on Trade and Development (UNCTAD) released its latest World Investment Report (WIR). In line with the general world economic outlook outlined above, the WIR estimates that world FDI flows will fall to below US$1.2 trillion in 2009 (from US$1.7 trillion in 2008), with greenfield investments hit badly during this year. A slow recovery is expected in 2010, with more significant growth in FDI inflows expected in 2011. UNCTAD note that cross-border mergers and acquisitions (M&As) have been declining, but that they expect these types of FDI could lead future recovery.

The UNCTAD report notes that the distribution of FDI inflows has changed. Investments into transition and developing countries increased their share of global FDI inflows in 2008, whilst the share of global FDI inflows going to developed countries fell.

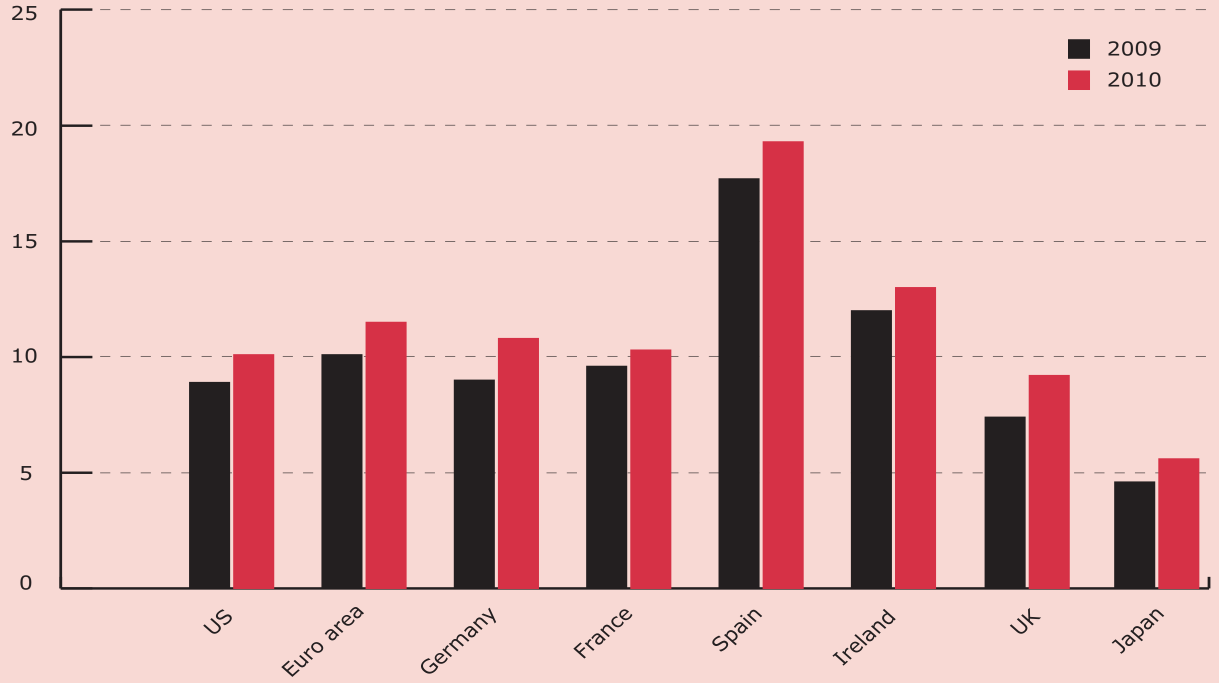
FDI inflows to the European Union fell by

Figure1: Output Growth Forecasts, Selected Economies, annual % change, 2009 and 2010



Source: IMF, *World Economic Outlook,* October 2009.

Figure 2: Unemployment rate, %, Selected Economies, 2009 and 2010.



Source: IMF, *World Economic Outlook,* October 2009.

Table 1: FDI Inflows by Selected Region/Economy, 2007 and 2008, (US$m)

Region/economy	**2007**	**2008**
World	1,978,838	1,697,353
Developed Economies	1,358,628	962,259
European Union	842,311	503,453
France	157,973	117,510
Germany	56,407	24,939
UK	183,386	96,939
North America	379,59	360,824
Developing and Transition Economies	620,210	735,095
South, East and South-East Asia	253,816	297,573
China	83,521	108,312
India	25,127	41,554

Source: UNCTAD, WIR 2009.

just over 40% between 2007 and 2008, whilst in the UK, the fall in FDI inflows was almost 50%. In North America the decline in total FDI inflows was due to a fall in FDI to Canada, which more than offset an increase in flows to the United States. FDI flows to China, although exceeding those of the UK in 2008, represent a relatively smaller amount of total capital investment in the economy (accounting for 6% of Gross Fixed Capital Formation in China, compared with almost 22% in the UK).

The UK economy

The UK economy has been in severe recession during 2009, following a period of very low growth in 2008. The IMF forecast that real GDP will fall by 4.4% in 2009, but will increase by 0.9% in 2010. The supply of credit to the economy has been significantly reduced due to the financial crisis and house prices have fallen, impacting on business and consumer spending. The expansionary monetary policy - very low interest rates and quantitative easing – has provided some cushion against the downturn in the economy. The deteriorating state of the UK public finances however remains a major topic of debate in the press and elsewhere.

Figure 2 shows that the IMF expect unemployment in the UK to rise still further next year, to over 9%. The OECD *Economic Outlook* 2009 noted that the increase in UK unemployment has been particularly high amongst younger workers, and that this is consistent with the pattern of unemployment across other OECD countries where '*youth, but also the low-skilled, immigrants and ethnic minorities – are bearing the brunt of rising unemployment*'. (OECD, *Employment Outlook* 2009)

UK Industrial production fell by over 10% in the year to September, however the Bank of England's Agent's summary of Business Conditions (September 2009) noted that there had been a modest recovery in export demand, and that some manufacturers were reporting growth (although from low levels). There has been some increase in car production, but other manufacturers of

Table 2: Regional Productivity by Selected Region: Gross Value Added per hour worked in 2007(UK Industry GVA per hour worked = 100)

	Wales	Scotland	N. Ireland	W. Midlands	N. East	London
Agriculture, Forestry & Fishing	51	109	66	173	114	16
Mining & Quarrying	119	72	72	137	113	87
Manufacturing	90	118	93	85	103	120
Electricity, Gas & Water	82	83	129	101	85	155
Construction	89	107	93	92	95	112
Wholesale & Retail	85	94	85	91	91	127
Hotels & Restaurants	88	92	93	116	93	110
Transport & Communications	73	94	84	81	97	127
Financial Intermediation	67	94	79	77	80	128
Real Estate, Renting & Business Activities.	101	95	108	87	91	107

Note: The numbers in Table 2 represent productivity in the particular industry such that average productivity of the same industry in the UK=100.
Source: Oguz and Knight, 2009 (extract from Table 3, p.46).

capital goods have continued to experience weak demand. The agent's summary also commented on the recovery in the housing market (see Property Market section). They reported that the growth in demand had been greatest amongst cheaper properties.

The Welsh Economy

The Labour Markets section of this *Review* shows the unemployment rate for Wales for the period April to June 2009 at 7.6%, marginally below the UK average. However that section also notes that Wales has a higher proportion of young unemployed compared with the UK. Given the OECD's comments relating to youth unemployed (above), and the forecast increase in unemployment in the UK and many other world economies, there is a strong expectation that unemployment in Wales could increase still further next year.

There are a few positive stories of job creations in the comings and goings section of this *Review.* These are mainly in the retail sector, such as the Asda development in Newport and the St Davids 2 development in Cardiff. However outside retail, there are few good employment news stories to report. As in the UK, the housing market is showing some early signs of recovery, with house prices rising in Wales in the third quarter of 2009. The construction sector has suffered falling output levels since the second quarter of 2008, however after four quarters of falling output levels, the index of construction output increased slightly in the second quarter of 2009.

A recent article published by the Office for National Statistics aimed to explore the determinants of inter-regional productivity differences by examining the data on the contributions of different industries to aggregate productivity in each region (Oguz and Knight, 2009). As part of this analysis, the article compared industry productivity in each region to a UK average.

Table 2 shows that in Wales, only mining and quarrying and real estate, renting and business activities had average productivity levels above the UK industry average in 2007, whilst a number of other industries fall far short of the UK average. As expected, most industries in London (and others in Greater South East area, not shown in Table 2) outperformed the UK average in terms of average industry productivity levels.

Table 2 only shows 10 industry groups for each region, and there is likely to be considerable variation in productivity levels within each aggregate grouping. For example, in Wales, the manufacturing sector as a whole is shown to have had average productivity levels of only 90% of the UK manufacturing average. However this average performance may disguise significant differences within different parts of the manufacturing sector in Wales.

The article, which also looked at other data, including productivity growth rates concluded that '*industrial structure only accounted for a limited proportion of the productivity gap between regions and the UK. It follows that regional differences in productivity within industries seem to be more significant in explaining the productivity gap, implying that labour productivity is influenced by the location of industry. Such differences may be due to variations in other factors affecting labour productivity, such as investment, innovation, enterprise, competition and skills as well as consumer tastes and preferences.*' (p.47)

The Treasury Poll of Economic Forecasts, reports that independent groups are expecting UK GVA growth to be around -4.3% this year, and +1.2% in 2010 (the IMF forecasts are given earlier). In terms of GVA growth, we do not expect the Welsh economy to 'outperform' the UK during this period, the forecast is for Welsh GVA to fall by 5% this year and with no growth expected in 2010.

Table 3 Forecast Change in Real GVA (%)

	2009	**2010**
Wales	-5.0	0.0

Reference

Oguz, S. and Knight, J. (2009), Regional Economic Indicators: with a focus on industries in the regions, *Economic and Labour Market Review*, Vol 3, No. 11, November.