Economic Commentary

World Economy
In October the International Monetary Fund (IMF) published its latest World Economic Outlook. This publication notes that whilst the global economic recovery continued to strengthen, this recovery remains fragile. The IMF expected that global economic activity will have expanded by 4.8% in 2010 and by 4.2% this year. Economic growth during 2010 was higher than had been predicted this time last year, and expectations are largely positive for 2011, although with uneven growth prospects for different world economies. According to The Economist (December 11th), 'America, the Euro zone and the emerging world are heading in very different directions, with very different growth prospects and contradictory policy choices' (p.13). Figure 1 shows output growth forecasts for 2010 and 2011 for selected economies, and illustrates the divergent prospects for the different economies shown.

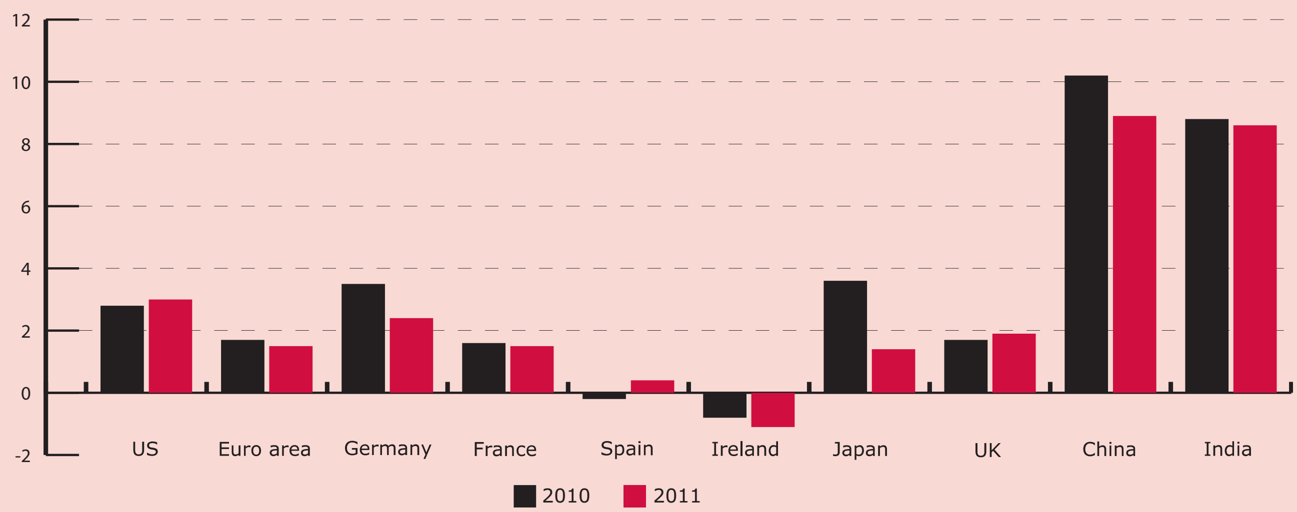
Economic growth in China and India, (and in some other emerging and developing economies) has been staggeringly high, even during the worst years of the financial crisis. These economies contributed most to world economic growth in 2010 and predictions are for strong growth this year. These growth forecasts coupled with rising prices in many of these economies suggests the possibility of overheating, and a need for tighter economic policy. Such policies would have a moderating effect on economic growth in future years, although these economies are still expected to outperform those of developed economies in the years to come. A recent report by Pricewaterhouse Coopers suggests that by 2050, when ranked by size of economy, and adjusted for price differences (using purchasing-power parity), five of the top seven economies will be those presently described as 'emerging economies'. China and India are both expected to have economies larger than America, although as noted in the report, due to higher populations, gross domestic product (GDP) per person will generally still be lower in the emerging economies than those in the 'advanced' economies (Economist, January 15th, p.89).

Economic growth in the US is expected to be around 3% in 2011, although there are some predictions that it may be considerably higher. In contrast to Euro area economies, economic policy in the US has been much less severe. Indeed there has been a tax cut agreement which has extended existing tax breaks and added new breaks. The stimulus to economic recovery is expected to reduce unemployment (which stood at 9.4% in December), but with some worries about the consequences for government revenues (and hence spending).

Economic growth in the Euro area is expected to slow this year, as the impacts of government spending cuts work through. Within the Euro area, the mixed fortunes of member countries can be seen from Figure 1. Germany, the largest Euro area economy had a strong 2010. Economic growth is expected to have been around 3.5% higher than in 2009, and industrial production was up by over 11% in the year to November 2010. There is expected to be some slowing of economic growth in Germany in 2011. However this economy will still perform well, and will prop-up the overall Euro area performance during this period. Spain is expected to return to positive (but low) economic growth in 2011. Industrial production in Spain increased by 2.7% in the year to November 2010, after falling by almost 4% in the year to October. However unemployment was an astonishing 20.6% in November. Economic growth prospects in other economies, such as Ireland, (and Portugal and Greece, not shown in Figure 1) are much worse. The Irish economy is expected to have contracted by around 0.8% in 2010, and that this will be followed by a fall of 1.1% this year. In Greece the forecast is that the economy will contract by over 4% in 2011.

Foreign Direct Investment
The World Investment Report 2010 (WIR, produced by the United Nations Conference on Trade and Development,

Figure 1: GDP Forecasts, Selected Economies, annual % change, 2010 and 2011.



Source: The Economist, January 15th 2011.

Table 1: FDI Inflows by Selected Region/Economy, 2007-2009, (US$m).

Region / economy	2007	2008	2009
World	2, 099, 973	1, 770, 873	1, 114, 189
Developed economies	1, 444, 075	1, 018, 273	565, 892
European Union	923, 810	536, 917	361, 949
France	96, 221	62, 257	59, 628
Germany	76, 543	24, 435	35, 606
United Kingdom	186, 381	91, 487	45, 676
North America	374, 371	379, 830	148, 540
Developing economies	564, 930	630, 013	478, 349
South, East and South-East Asia	258, 830	282, 440	233, 050
China	83, 521	108, 312	95, 000
India	25, 001	40, 418	34, 613
South-East Europe and the CIS	90, 968	122, 588	69, 948

Source, UNCTAD, WIR 2010.

UNCTAD), predicts that most regions will have seen a rebound in FDI flows during 2010. During 2009 world FDI flows fell to below US$1.2 trillion, and the figure for 2010 is expected to exceed this level, with a rise to US$1.3-1.5 trillion in 2011, and a further increase in 2012. The WIR however notes that these growth projections are closely tied to global economic performance and are subject to high levels of uncertainty.

The UK economy

Economic activity in the UK fell by almost 5% during 2009. During that period the UK economy faced a credit squeeze, due to the financial crisis and house prices fell, both impacting on business and consumer spending. The economy in 2010 is expected to have grown by around 1.7%; this is higher than had been previously forecasted by the International Monetary Fund (IMF) and others. Provisional data for 2010Q4 shows that the economy contracted by 0.5%, following growth of 0.7% in the previous quarter. In their press release the Office for National Statistics (ONS) comment that '*the change in GDP in Q4 was clearly affected by the extremely bad weather in December.....The disruption caused by the bad weather in December is likely to have contributed to most of the 0.5% decline, that is, if there had been no disruption, GDP would be showing a flattish picture rather than declining by 0.5%*'. The ONS do however note that figures relating to the impact of the bad weather are still subject to uncertainty at this stage (ONS, 25th January). This turnaround in economic fortunes was not expected, and is due to contractions in the construction sector (with GDP down by 3.3%, the largest contributor to the overall decline) and in the services sector of the economy. There was positive GDP growth during the final quarter of 2010 in manufacturing and utilities. This fall in economic activity, together with other recent information on the labour market (see below) has raised fresh concerns about a possible double-dip recession this year.

The UK unemployment rate increased to 7.9% for the September – November 2010 period (see Table 4 later), with 2.5 million people now unemployed, and this trend is expected to continue as the public sector spending cuts outlined in the Spending Review work through the economy[1]. The Institute of Public Policy Research (IPPR) warned of a 'double-dip' jobless rise and of the risk that economic growth will not be fast enough during this year to prevent unemployment reaching new highs. The IPPR have suggested that economic growth needs to be more than 2% for unemployment to fall (BBC News, Business, 18th January). Of most concern, is the record number of 16 to 24 year olds who are without work - the unemployment rate for this group increased to 20.3%.

Figure 1 shows a small increase in the UK GDP forecast for this year. (However the OECD forecast for the UK economy, published in November, suggests 2010 will have seen growth of 1.8%, falling marginally this year to 1.7%.) This forecast precedes the 2010Q4 economic growth estimates, and as already noted prospects for the UK economy are highly uncertain. In addition to the austerity measures, there is the recent VAT increase and higher than expected inflation rates which will put pressure on the economy. In this situation it is indeed difficult to see where the predicted economic growth will come from.

The Welsh Economy

The Labour Markets section of this *Review* shows that unemployment in Wales is above the UK average at 8.4%. This represents 123,000 people (an increase of 4,000 on the previous quarter, although declining slightly over the year). In line with previous predictions about the Welsh economy, and expectations about the UK economy, there is every chance that unemployment in Wales could increase still further, particularly as Wales has a relatively high concentration of public sector employment compared to other parts of the UK (see Table 8). The Welsh Assembly Government has commented that its budget will be cut by £1.8bn in real terms over the next four years as a consequence of the Spending Review (although this figure varies from that given by the Treasury, which, for example does not include inflation in the calculations).

In December 2010, the ONS released data for regional, sub-regional and local gross value added (GVA). Table 2 gives an extract of the regional data provided, showing a time series of GVA per head indices for 1989, 1999 and 2009. The table shows that London and the South East (as would be expected) far outperform other regions of the UK, with London recording GVA per head of over 171 in 2009 compared to the UK average of 100. By sharp contrast, Wales has fallen from third from last position in 1989, to last place in 1999 and 2009, with the gap between Wales and the UK widening for each year shown.

The sub-regional and local data contained in this latest press release relates to 2008. At the sub-regional level (NUTS2), West Wales and the

Table 2: GVA Per head Indices[1], UK = 100.

	1989	1999	2009[2]
North East	83.4	78.1	78.2
North West	91.3	88.2	86.4
Yorkshire and the Humber	89.5	87.3	82.9
East Midlands	94.9	90.2	86.8
West Midlands	91.8	90.8	84.0
East of England	95.3	94.0	93.1
London	156.9	160.7	171.2
South East	100.2	106.8	104.7
South West	91.9	92.0	91.2
Wales	84.3	77.3	74.3
Scotland	96.0	94.5	98.8
Northern Ireland	73.1	79.4	79.1

Notes:

1. GVA per head indices at current basic prices on a workplace basis, based on a weighted 5-year moving average.
2. 2009 estimates are provisional.

Source: ONS, December 2010.

Valleys is bottom of the UK table, with GDP per head only 62.6% of the UK average. At the local level (NUTS3), the Central Valleys, Gwent Valleys and Isle of Anglesey are all in the bottom five of UK local areas, with Isle of Anglesey last in the table. In 2008 GDP per head in Anglesey was just 55.2% of the UK average.

Table 3 shows Forecasts for the Welsh economy for 2010 and 2011. Unfortunately Wales' economic performance is expected to lag behind that of the UK for the foreseeable future, hence the prospects for any narrowing of the GVA gap with the UK are poor. No growth is expected for 2010, and growth of 0.5% is forecast for this year.

Table 3 Forecast Change in Real GVA (%)

	2010	2011
Wales	0.0	0.5

Note

1. The Spending Review is a Treasury-led process to allocate resources across all government departments, according to the Government's priorities. Spending Reviews set firm and fixed spending budgets over several years for each department. It is then up to departments to decide how best to manage and distribute this spending within their areas of responsibility.
   http://www.hm-treasury.gov.uk/spend_spendingreview_introduction.htm
   Full details of the October 2010 Spending Review can be found at
   http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf