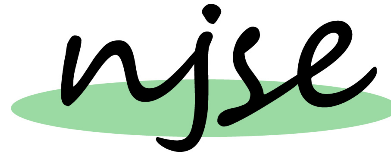

Strategic Economics Report

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Headlines

The UK economic recovery is real and an upturn is imminent. It is not yet, however, secure or sustained. Despite a continuing mix of tight fiscal and loose money policies, it remains vulnerable to external 'shocks', persistent deficits and other structural problems.

Compared with this national background, the SW economy currently performs quite well. But, if it is to compete successfully in the long run, it needs to rebalance aspects of supply and demand. Raised productivity, through increased investment and exports, remains the path to better real earnings and higher overall living standards.

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Executive Summary[2]

The **UK economy** is improving: growth forecasts for 2014 are being revised higher; the unemployment rate is low; and, at last, inflation is back on target. On the face of it, the whole economy is near to a 'sweet spot' where the economy is approaching a key boundary: the end of the downturn and the start of an upturn. From now on, the question is how sustainable the upturn will be.

Sadly, there are still lots of 'clouds on the horizon', especially from the **international environment**. The risk of 'shocks' from the unwinding of accommodative US monetary policies, Eurozone debtor/creditor policy pressures and tensions, Chinese debt and structural shifts, Emerging market adjustments, and political and military events in the Ukraine, Syria and elsewhere, remain profound. It would not take much of a rise in uncertainty for the more positive prognosis of the current 'central view' to be reversed.

There are also important **political and economic issues** to be resolved at home. First, the Scottish referendum in 2014, the UK General Election in 2015 and the prospect of an EU membership referendum in 2017 all have the potential to create market and business uncertainty, delaying or skewing investment (especially inward investment) and wider expenditure decisions to the detriment of underlying growth trends and future potential.

Second, there remain some key competitive constraints: the UK's public sector debt to GDP ratio exceeded 75% in the final three months of 2013 and is still forecast to increase for the next few years; the trade deficit, at a net £26bn in 2013 for goods and services, continues to be excessive; productivity ratios are very poor, (with manufacturing output per hour falling in each of the last seven recorded quarters); and average earnings are still rising less than inflation.

The bottom line is that, to date, the UK recovery is consumption and housing led – potentially a short-lived replacement cycle. Unless a bigger contribution is provided by investment and exports, doubts about the sustainability of any upturn will persist.

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Economic Profile

National Overview

The UK economy has been making progress for almost a year:

a) Real GDP growth reached 1.9% in 2013 and forecasts for 2014 are being revised higher - (I think growth could exceed 3% this year);

b) The unemployment rate (7.2% in the three months to January 2014) is close to the Bank of England's 7% 'forward guidance' threshold - (see Policy Issues below); and

c) Inflation is back to the 2% target (1.9% in year to January 2014).

A current 'snapshot' of the economy would show, at long last, that it is approaching the peak level of activity achieved in 2008. Perhaps, after six years of downturn, this level will be passed by the middle of 2014, starting a real upturn.

Important issues remain, however:

a) The UK's public sector debt to GDP ratio exceeded 75% in the final three months of 2013 and is not expected to fall soon (see Policy Issues);

b) The trade deficit continues to disappoint (again, almost £108bn for 'goods' in 2013);

c) Productivity ratios are poor (manufacturing output per hour fell in each of the seven quarters to Q3 2013); and

d) Average real earnings are still shrinking for most people. Though this may change in the year ahead, the 'hole' created since 2008 will persist for quite some time.

So far, the recovery is being 'pulled' along by consumption and housing, reflecting a replacement and pent up demand cycle. With household real incomes still under pressure and interest rates artificially low, doubts about the sustainability of the recovery will persist. There needs to be a stronger contribution from the 'push' factors of investment and exports. Weaknesses in these areas remain the "Achilles Heels" of the UK economy.

Against this macroeconomic background, manufacturing is recovering - (the latest GDP release suggested it increased by 2.6% in the final quarter of 2013 compared with a year earlier). But, it still has ground to make up. In 2013, manufacturing was 0.6% lower than in 2012 and total

manufacturing output remained 9.1% down on the pre-downturn high at the end of last year. There are signs of good manufacturing growth in early 2014 but 'gaps' in capacity and levels remain important.

Several manufacturing sectors and companies weathered the downturn well and are now on an upward trajectory – particularly, those with high added value, cutting edge products and those selling to the stronger international markets. But, performance has varied enormously by sector. As the table below reveals, there was a wide range of experience in 2013 from a 'mini-boom' in transport equipment/motors to a 'bust' in other machinery and clothing.

UK Manufacturing output in 2013 (% change on 2012)

Foods	-2.2	Chemicals	-0.7	Machinery	-11.8
Beverages	+2.7	Pharma	-2.2	Motors	+8.1
Textiles	-4.1	Metals	+6.6	Transport	+9.0
Clothing	-9.5	Electrical	-4.5	Total	-0.7

Source: ONS

Two key questions remain.

First, has the downturn resulted in a permanent or temporary loss of overall manufacturing capacity?

Second, when will investment spending pick up?

On the first question, time will tell, but the huge goods trade deficit indicates that large gaps persist in the UK's manufacturing supply chain and suggests an on-going imperative to spread 'best practice' across UK manufacturing and to encourage 'reshoring'. At the moment, a manufacturing recovery does not necessarily mean an overall recovery because of our high dependence on imports of materials and intermediate components.

On the second question, recent surveys offer some positive news.

In line with the better, but still problematic, overall economy outlined earlier, respondents to the latest proprietary surveys suggest a more positive outlook for manufacturing activity generally and the SW economy in particular. The January purchasing managers' (PMI) series, for example, leaves no doubt that prospects are improving across the SW region compared with its own experience over the last few years and compared with other parts of the United Kingdom. In this, and other surveys, such as those by the Manufacturing Advisory Service, the Chartered Accountants and the Chanbers of Commerce,

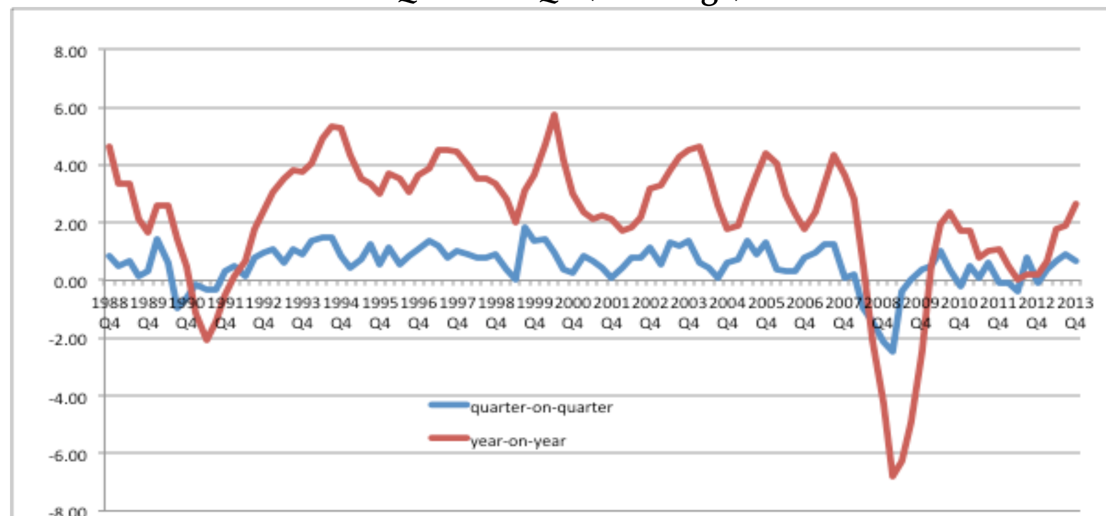
larger percentages of private business respondents are expecting higher turnover and more employment, in 2014.

Moreover, more enterprises are considering higher investment in plant and machinery, business premises and new technologies. Given the need for 'economic rebalancing' in demand patterns and sector supply (output, employment and trade), the UK economy would be helped by a wave of increased investment that pushed growth towards higher productivity, exports and better returns. Any increase in innovation-led investment, as suggested by recent surveys, would be a welcome sign for a more sustainable recovery.

Recent Data & Trends:

Real GDP ended 2013 on a reasonably strong note. In the final quarter, it was 2.7% higher than a year earlier – the fastest rate of annual percentage change since the first quarter of 2008. As the chart below shows, this series has been accelerating over the past year. The good news is that more areas of demand and output contributed to recovery in the latest quarter. Real growth may be returning to the 'normal' above 2% range of the 1990s and 2000s, though it is too early to be sure.

UK real GDP trends: 1997 Q1 - 2013 Q4 (% change)

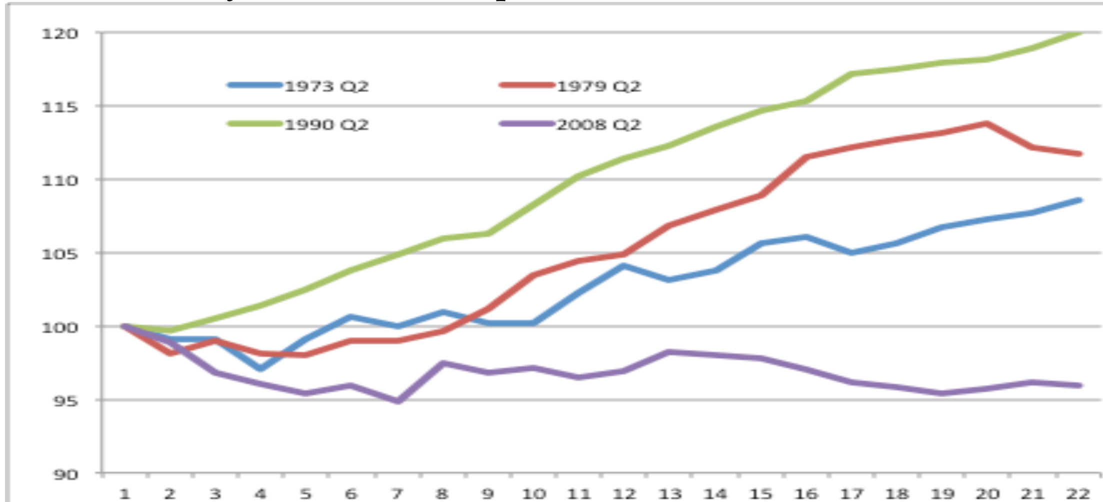


Source: ONS data

A key reason for caution is the poor *productivity* performance of the UK economy. As the next chart (which sets the previous peaks at 100 and tracks subsequent performance against that base) shows, the level of output per hour in this downturn has failed to recover to its pre-

recession peak. This is so different from the previous equivalent trends whereby productivity was well above previous highs within a year or two of the 'bust'. The positive obverse of this, of course, is higher employment than otherwise may have been the case. Nonetheless, a sustainable upturn can only occur if the productivity line now recovers. Ultimately, this represents the only secure path to real increases in earnings and higher standards of living.

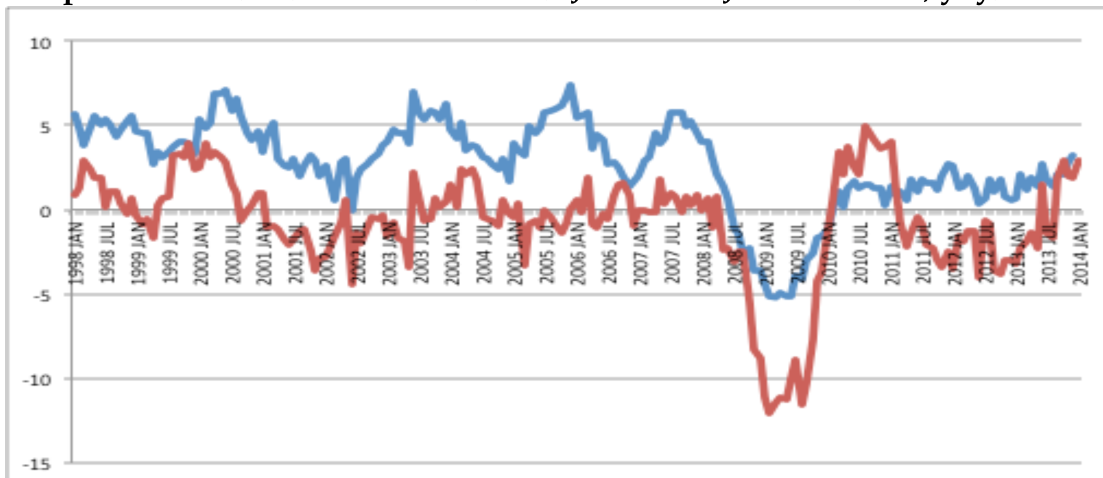
UK Productivity: Downturns compared



Source: ONS data

In broad sector terms (see next chart), the trend in UK services output picked up steadily through 2013 whilst the production trend accelerated more sharply. Both series could do with more momentum if a sustained upturn is to emerge but, at least, both are now growing at rates consistent with recovery. The *supply side* of the economy is moving more positively.

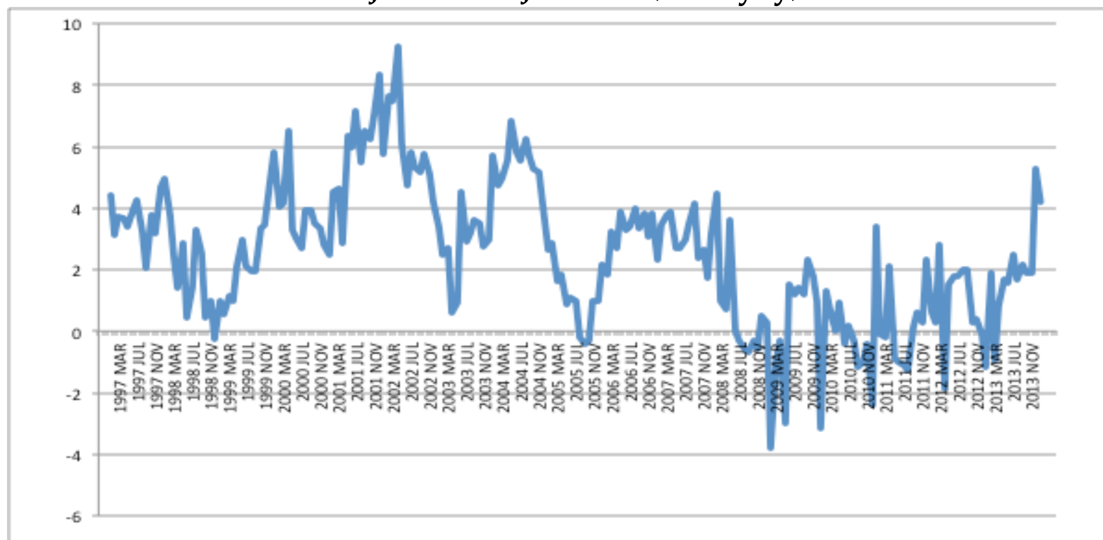
UK production (red) & services (blue): Jan 1998 – Jan 2014 (%ch, yoy)



Source: ONS data

On the *demand side*, households seem to be increasing consumer expenditure. Retail sales volumes (next chart) remain volatile from month-to-month, strongly influenced by temporary factors, (including weather conditions), but the year-on-year series has been consistently positive since mid-2013 and has moved to a higher rate of growth in recent months. Strong shifts persist within retailing, such as the trends towards on-line durables and grocery discounters and away from more traditional stores and locations. Overall, however, a more positive outlook appears to be appropriate.

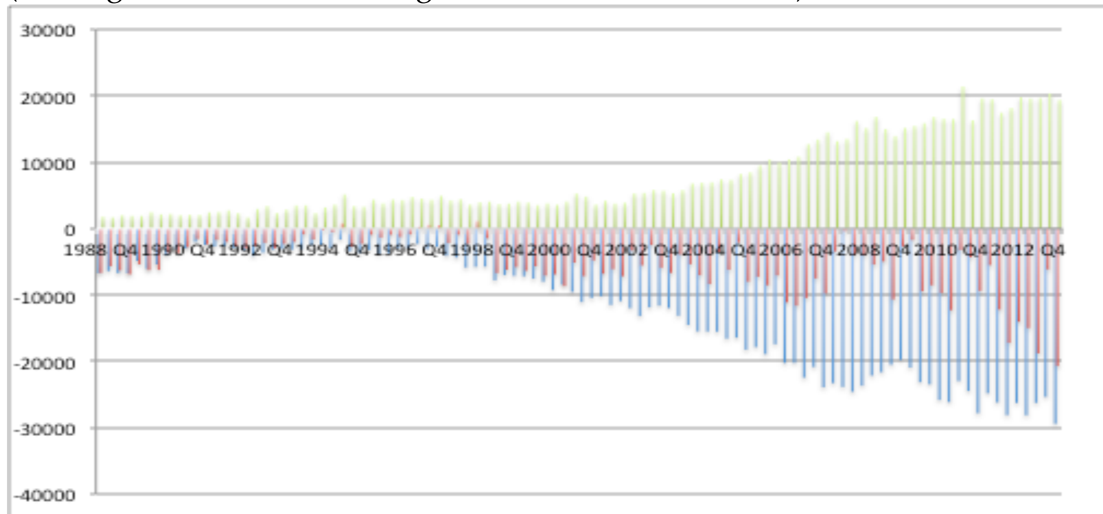
UK retail sales volumes: Jan 1997 – Jan 2014 (% ch yoy)



Source: ONS data

The external position of the economy remains poor. The *current account* deficit is still too high, with a growing goods deficit only partly offset by a growing services surplus (see chart below). In the third quarter of 2013, the current account/GDP ratio was 5.1%. (N.B. anything above 2.5%-3.0% is usually considered unsustainable.) For the year as a whole (data out shortly), it will be lower. Nevertheless, to get back to a ratio that we could be relaxed about requires a significantly better export performance, especially for 'goods': one that reduces the trade deficit and fuels services and financial flows. A better economic balance in international trade is a prerequisite of a sustainable recovery. That means increased competitiveness and, again, that means a stronger productivity performance. For the UK economy, we keep coming back to the same chain of logic that links growth to investment, productivity, trade, business and household earnings.

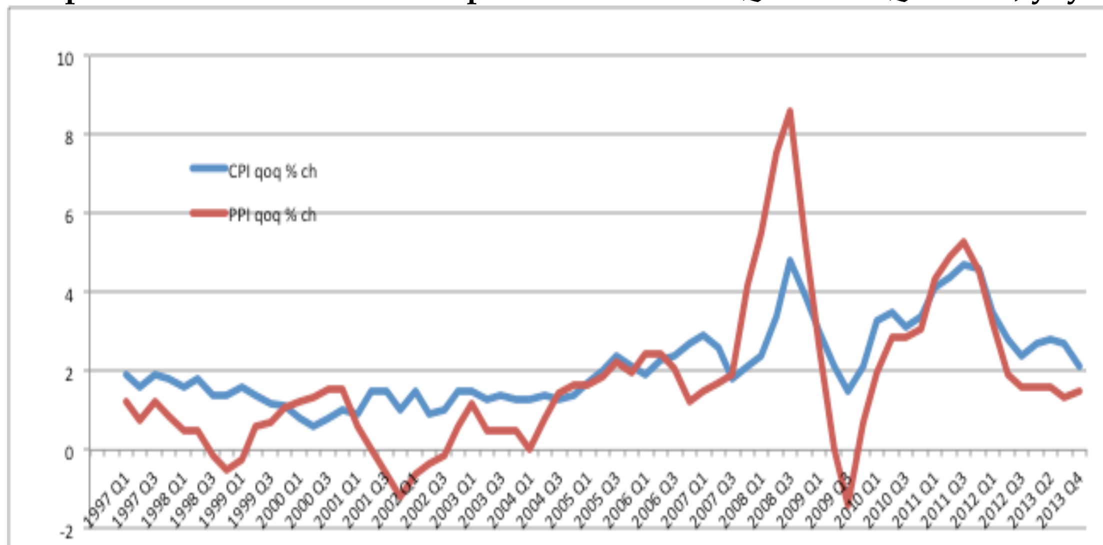
UK balance of payments: 1988 Q4 – 2013 Q3 (£mn):
(blue - goods, red – services, green - net current account)



Source: ONS data

Meanwhile, the *inflation* series appear to be coming under control (see next chart), despite the 'cost of living crisis' and incredibly loose monetary policy. Producer price inflation has been below consumer price inflation for the last couple of years, which tends to pull the latter down. The question is whether a sustained recovery in growth will allow the dampening of inflation to continue. I suspect there is still considerable inflationary potential pent up in the economy (through the loose money and unrealised wage pressures). It is unlikely, however, that this will show through in the numbers for some time. Arguably, the authorities have time to get it right but let's hope they do not wait too long.

UK producer (red) & consumer prices (blue): 1997 Q1 – 2013 Q4 (% ch, yoy)



Source: ONS data

Policy Issues:

The ECB (0.25%), Bank of England (0.5%) and Federal Reserve (0.25%) are all keeping *base interest rates* at very low levels. Most forecasters expect them to stay that low through 2014 and only rise a little in 2015. In recent evidence to Parliament, on the fifth anniversary of UK base interest rates being so low, Governor Carney of the Bank of England (BoE) said we should expect official rates to rise over the next few years but very slowly - perhaps up to 2%. Through its own version of "forward guidance", the 'Fed' is also preparing Americans for gradual interest rate increases. It has also started to 'taper' its *quantitative easing*, ahead of the BoE. There is nothing that should "scare the horses" here. Indeed, if they leave monetary re-tightening too long, there seems to be a greater risk of new "credit bubbles" than of "killing growth" in the 'anglo' economies. This is not so in the Eurozone.

All businesses and consumers, in America and Britain, should be planning for slightly higher interest rates in the next few years. However, none of this should threaten the recovery because interest rates will still be a lot lower than historical 'norms'. Also, loan margins over base are already wide and should be able to accommodate this 'nudge' in base rates without any need to move rates up for current borrowers. Indeed, my own view is that an increase in base rates would be welcome right now. It would be beneficial for prolonging the upturn, if only because it will start to provide some incentive for savers and investors to fund further development.

There is now a debate as to what *'normal' rates of interest* are. The historical argument, for example, is that UK base rates tend to move around 4.5-5.5% over the economic cycle; made up of a 2.5-3.0% trend potential of real growth and a 2.0-2.5% rate of underlying inflation. The 'new' argument, however, is that the prolonged downturn has 'changed the game' fundamentally and the new 'normal' will be permanently lower: perhaps 3.5-4.5%. My immediate reaction is that "nothing is permanent" in the economy but let us consider the arguments for lower interest rate 'norms' – at least for the foreseeable future. (David Miles, a member of the BoE's Monetary Policy Committee, has developed these arguments in a recent speech - see the Bank's website for links.)

- First, it is suggested there is a changed concept of 'safe return'. Simply, the 'great recession' has shown that the authorities will do anything to prevent depression and to manage deflation/inflation worries and,

therefore, expectations of the risk-free (UK gilts?) interest rate can be lower 'forever'.

- Second, there is the argument that the real trend rate of UK growth is going to be lower: a) because of the damage to underlying growth potential of the recent long downturn itself and b) because of the long-term effects on growth potential of the ageing population.

- Third, the spread between 'risky' and 'safe' interest rates has permanently widened. For most of us, lower base rates do not mean lower loan (mortgage and other credit) rates and the margin of association between the two has widened.

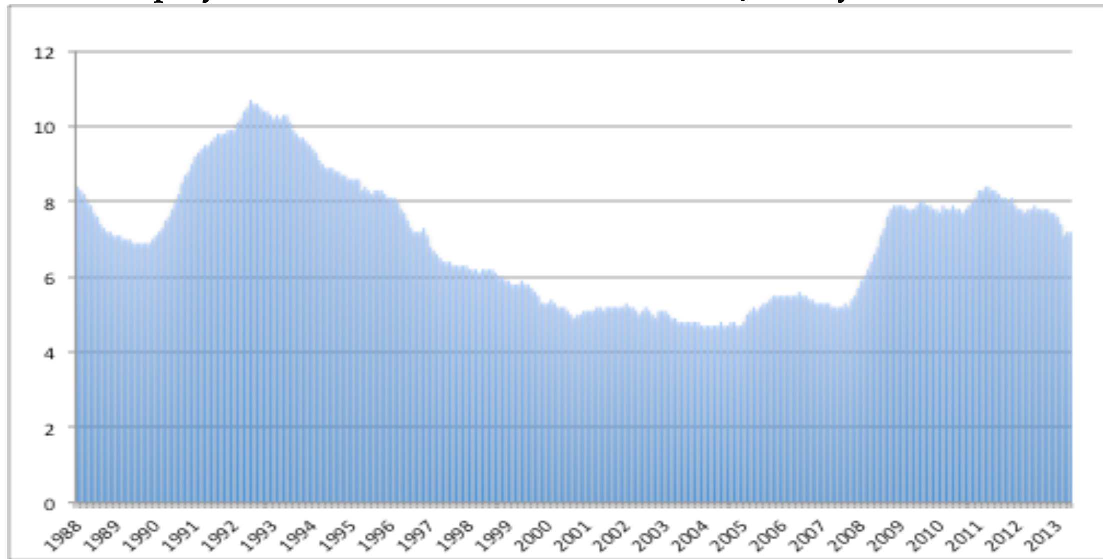
- Fourth, the Bank of England balance sheet is much bigger – until that is unwound, prolonged high money supply means money stays cheap.

- Fifth, perceptions of 'catastrophe risk' have changed: the fear of new negative 'shocks' will keep a low ceiling on official rates and markets know that.

It does seem likely that aspects of these factors will restrain base interest rate increases for several years, although I do not believe it can last forever. At some point, assuming no further disruptive events, a sustained upturn will deliver a resurgence of growth and inflationary expectations. Moreover, some of the five factors above, especially market expectations and wider confidence in policy makers can shift quickly as 'events' evolve.

Still, we can probably ignore the risk of a full return to 'normal' interest rates for now - possibly for the next three years. Moreover, in Europe, the balance of risks is still the other way. Deflation, especially in the debtor parts of the euro-zone, is a real concern on the continent. Recently, Martin Wolff of the Financial Times has talked about the Eurozone being "one shock away from deflation". This is much scarier than the risks of higher interest rates in the 'anglo' economies. The ECB need to watch this closely and avoid a repeat of the errors that caused Japan's experience of prolonged under-performance since the 1990s.

UK Unemployment (% LFS rate) December 1988 – January 2014



Source: ONS data

Meanwhile, the BoE has dropped its 7% *unemployment target* almost before it began because the UK economy seems to be getting there earlier than expected. The chart above shows the truncated nature of the higher unemployment caused by the recent downturn and how it has started to moderate in recent months. Now, the Bank's MPC says it intends to monitor a wider range of statistics and other evidence to judge when to start to unwind the loose monetary stance. This looks like 'Déjà vu all over again' – a return of the policy pendulum back towards more judgemental monetary action rather than decisions driven by numerical targets or prescriptions.

<u>Fiscal Policy</u>

The *pre-election Budget* of March 2014 was a little less austere than its recent predecessors, although the Chancellor suggested that 'austerity' in terms of overall taxation and government spending would have to remain in place throughout the next parliament (2015-20). Much was made of the fact that the recovery is real and prospects of growth are better but, (as the table below shows), the official economic outlook remains, at best, modest.

Indeed, really the macro perspective is little changed with the upward revisions to near term growth 'paid for' or 'borrowed' from the mid-term. The Chancellor is promising even tighter public spending restraint after the next election and the opposition does not gainsay thjis approach. The small 'giveaways' in recent announcements are more to do with bolstering support for next year's General Election

than any fundamental shift in fiscal policy or macroeconomic prospects.

Office of Budget Responsibility Forecasts: March 2014

	2013	*2014*	*2015*	*2016*
Real GDP	+1.8	+2.7	+2.3	+2.6
Household consumption	+2.3	+2.1	+1.8	+2.5
Business investment	-1.2	+8.0	+9.2	+8.1
Government consumption	+0.9	+1.2	-0.5	-1.2
Net trade contribution	+0.1	-0.2	+0.1	0.0
CPI inflation	+2.6	+1.9	+2.0	+2.0
Employment	+1.4	+1.7	+0.7	+1.0
Implied productivity	+0.4	+1.0	+1.6	+1.6
Implied real earnings	-1.1	+0.6	+1.2	+1.6
	2013/14	*2014/15*	*2015/16*	*2016/17*
Current budget deficit	-4.4	-3.3	-2.3	-0.7
Public sector net debt/GDP	74.5	77.3	78.7	78.3

Source: OBR

Indeed, in the medium term, although a bit better, there is no significant increase in the contribution of investment and net trade whilst growth remains anchored around 2.5%. Also, whilst productivity growth recovers to 1.6% per annum, it does not get strong – certainly, not to rates really competitive with our stronger international rivals. (It would need to get well above 2.5% for that.) As a result of the OBR's modest economic prognosis, the adjustment of the public debt, whilst better than was thought as recently as December, remains extremely slow. There is no downward shift until 2016/17 and, then, we will still have a higher ratio to GDP than we have today.

Against this background, the Chancellor offered a budget for *"makers, doers and savers"*. The measures to support business investment, to reduce business energy costs and to boost export engagement are welcome. The rhetoric is appropriate, supporting all the incontrovertible arguments for rebalancing the economy towards more productivity-led growth. The actions promised will help, yet the OBR forecasts suggest the impact will be extremely limited in macroeconomic terms.

In 2010-12 we were critical of the government's fiscal approach for not being right for the condition of the cyclical economy at that time. We are now much more supportive, believing that the fiscal stance is now more appropriate for the current and prospective state of the economy.

The present issue is, however, whether enough has been done in terms of providing strong incentives for investment, trade and development.

There was little of specific interest to the SW economy, as opposed to any other part of the United Kingdom, in the latest fiscal announcement. As always, the question is whether SW households and businesses react to the incentives offered in a way that boosts absolute and relative regional competitiveness, rebalancing the economy and its businesses towards higher value added and productivity-led activities. As it has for decades, the challenge remains the dissemination of 'best practice', the growth of higher aspiration, and the expansion of value added capacity across the region.

Local Overview

The **SW economy** exhibits many of the recent UK business conditions but it also has some interesting characteristics of its own:

First, in the second half of 2013, the ***purchasing managers'*** (PMI) survey from Lloyds/Markit showed the SW region outperforming its rivals. In December, the output index touched 62.4 – a level indicating strong expansion and a higher index than in any other region or devolved administration. Employment also expanded, reaching 58.6 - again, the highest in the country. In January, these numbers slipped a bit but the region remained well ahead of most others. *Other surveys* have been equally buoyant, ranging from the Manufacturing Advisory Service, through the Chartered Accounts, to the CBI and Chambers of Commerce. All expect higher orders, turnover, investment and employment from SW businesses in the months ahead.

Second, whilst ***unemployment rates*** were falling everywhere else, they were increasing in SW England through 2013 (see chart below). For example, in the three months to November 2013, the UK average unemployment rate was 7.1% compared with 6.8% for the South West. In the same period a year earlier, the equivalent rates were 7.7% and 5.5%: the national rate fell as the local rate increased. Over the last year, this more comprehensive SW measure of unemployment appeared to deteriorate markedly even though the narrower claimant count rates were coming down, and continued to compare very favourably, right across the SW patch. In December and January, however, there was a reaction and the SW rate has fallen again to less

than 6% (see chart). The regional series is always going to be more volatile than the national average but these bouts of divergence in trends remain intriguing mysteries. Perhaps, they reflect different patterns of behaviour with regard to surveyed inactivity, hidden and revealed unemployment and flexible employment.

UK & SW Unemployment (% LFS rate) July 2007 – January 2014

Source: ONS data

Meanwhile, in February 2014, the ***claimant count rates*** for the region's six Local Enterprise Partnership areas were all low: Dorset and Swindon & Wiltshire 1.8%, Heart of the SW (Devon and Somerset) 2%, Gloucestershire 2.1%, West of England (Bristol and its neighbours) and Cornwall and the Isles of Scilly 2.3%.

The conundrum of a widening gap between the two 'headline' unemployment measures probably reflected: 1) changes to policies and incentives to 'sign on'; 2) survey volatility in the wider measure; and 3) changes in household confidence moving previously 'inactive' labour to a more 'active', though not yet employed, status.

Third, new ***productivity*** data for 2012 shows the SW region to be 8.4% worse than the UK average in terms of GVA per hour. This means it ranks in the middle – (sixth highest amongst the nine English regions and three devolved administrations) - on this crucial indicator of economic performance. SW England is comparable to the North West, well below the South East, and well above Wales on this productivity measure

This all seems to suggest a SW economy that has some current strengths but also some underlying structural weaknesses. We tend to employ our people but we still need economic restructuring
a*) in demand* - less dependence on government and consumer spending and more on business and export spending, and
b) *in supply* - sector shifts towards higher productivity growth based on innovation and skills, entrepreneurship and competitiveness. The latter would be the best, long run, guarantor of high employment and high standards of living across SW England.

Meanwhile, at long last, in response to the requirements of the Allsopp Commission of 2003 and, perhaps more pertinently, to meet EU requirements by 2017, the ONS has started to release experimental statistics on ***real growth at a sub-regional level***. (Those who are interested technically should refer to the ONS Real GVA release of 31st January 2014). When finally approved and regularly released, this new data will fill an important gap in the local, economic evidence base, providing real Gross Value Added (GVA) statistics at a more useful level. By giving information about the real levels and trends in production-based economic activity, it should be as important as the real GDP releases at a national level for local policy makers, business planners and researchers.

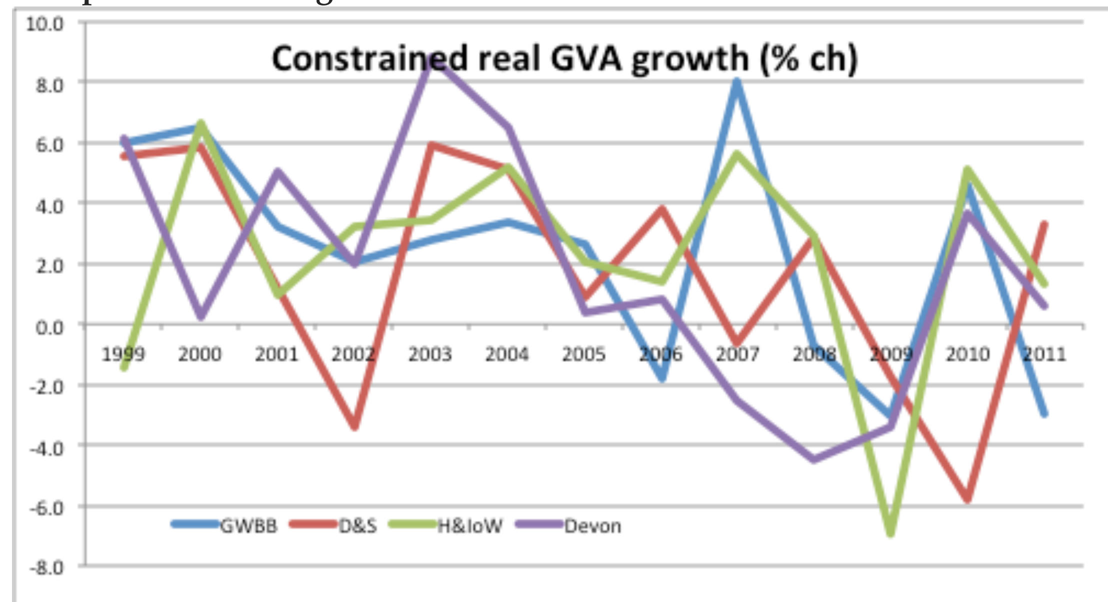
The data that has just come out - for consideration by, and comment from, users - for the first time, means we have official, albeit experimental, real growth rates for high level SW areas. These numbers can be compared with those of other similar areas, (as defined in agreement across the EU as NUTs 2 geographies). For example, the chart below shows the real growth rates for 1999-2011 for Dorset and Somerset (D&S – red line), Gloucestershire, Wiltshire, Bristol and Bath (GWBB – blue line), Hampshire and the Isle of Wight (H&IoW – green line) and Devon (purple line)

The first thing to note is the *volatility* in these series. These areas do not simply follow the national trend in any particular year, though they are constrained by it over the long run. If reliable, these figures suggest that, within the overall trend of decline to recession and recovery during this period, the best forecast of this year's growth will often be a change in direction from, last year's growth. The trend data suggests the worst year of the recent downturn varied across these geographies - 2008 (Devon), 2009 (GWBB and H&IoW) and 2010 (D&S).

If the current recovery is sustained, it will be interesting to see if we can get back to real growth rates of about 3% per annum at a local level. Will we have to tolerate lower growth rates than before because of the *lasting damage* of the long downturn or can *economic rebalancing* push us to even higher rates of growth?

This is where the overall economic development debate should focus across SW England in the years ahead. What kind of aspiration for growth fits with a realistic assessment of capacity? What changes do we need to make in terms of structure, investment and ambition to 'raise our long-term competitive game'?

Comparisons of real growth



Source ONS experimental 2014

At the moment, the key problems with these new statistics are that they are not totally reliable and they out of date. We need figures for 2012 and 2013 to make them more useful and to be able to forecast well for 2014 and 2015. Nonetheless, this year (2014), we might see a general recovery to the 2-4% range of SW real growth. The really interesting question is whether this can then be maintained or accelerated in 2015-16.

The ONS experimental sub-regional, production-based, real GVA estimates may be nothing to get too excited about just yet. As time goes by and the data in this area is improved, however, it should become an important benchmark for those trying to understand and take action in support of local economic development. Something for those concerned with the local economy to watch out for over the coming years.

Economic Prospects

UK Economy

There is growing evidence that the UK economy is improving. Uncertainty persists, especially as to whether the demand-led recovery will fizzle out before enough new investment kicks in to sustain it. Through 2014, we will be looking for more investment-led growth and less reliance on housing-led consumption to support a prospective upturn.

The table below shows our *latest growth forecasts* compared with the official view. Basically, we think the Office of Budget Responsibility (OBR) is still being too cautious about the pace of the recovery, though we agree with the overall pattern over the longer run.

In essence the global, national and local conditions explained and risks identified in this report fit with an economy struggling to sustain any acceleration into the medium term. The OBR suggests the underlying trend rate of growth is about, or just under, 2.5%. We suspect this view is appropriate for the near term – (the next three years) - but we are prepared to be surprised on the upside and are more optimistic beyond that, especially if the rebalancing measures being encouraged by government and, particularly, taken by private businesses provoke a permanent step up in productive potential.

UK Consensus and Strategic Economics Forecasts: Real Growth

Real GDP growth	**2014**	**2015**
HMT Consensus	2.7	2.4
OBR	2.7	2.3
Strategic Economics	3.0	2.7

Source: HM Treasury (February 2014), OBR (March 2014) and Strategic Economics Ltd (March 2014).

Our final chart (below) shows three possible outlooks that encompass most views about the path of the UK economy over the next decade. It is important to note that these are stylised 'stories' of development and not 'single point' forecasts. We are merely trying to capture the pattern rather than to predict actual outcomes.

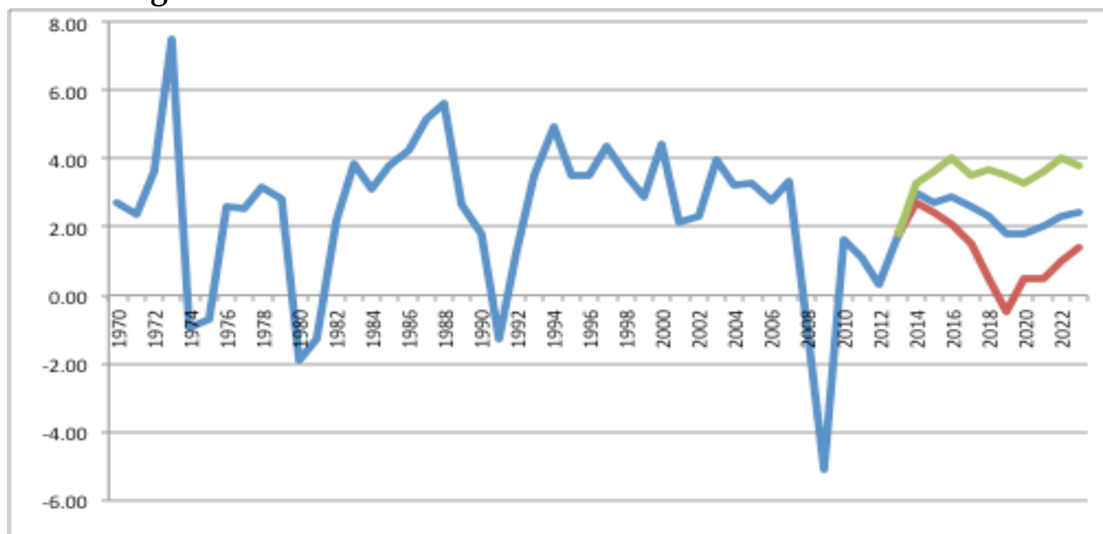
- The 'blue line' reflects the consensus view that the recovery will maintain the long-term trend decline (seen over the last few decades) in the UK's underlying rate of real growth to a range of 2.25%-2.5%.

This suggests a modest recovery will be maintained.

- The 'red line" reflects the uncertainties and risks of further 'shocks' from a range of possible global events and the belief that the downturn has damaged our productive capacity. It also assumes that, without real rebalancing that changes the UK's debt and productivity performance and some accommodation of demographic and environmental factors, the trade and public deficits and other structural weaknesses of the UK economy mean further painful adjustments and constraints on growth, including a brief return of recession at some point.

- The 'green' line reflects the view that fundamental rebalancing is underway, that the world's problems ease, and an investment/productivity-led change in economic prospects occurs. It indicates that the long downturn can result in a fundamental, positive shift in growth potential by changing investment patterns and aspiration. Moreover, the threats of an aging population and a warming climate can result in a positive economic response.

UK Strategic Economics Forecasts: Real GDP Growth



Source: Strategic Economics Ltd

In reality, the economy is likely to follow a path that incorporates aspects of each of these three 'stories'.

It would be odd if there were not further global 'events' that disrupt the smooth upturn. Also, we cannot expect as long a period of upturn as was experienced last time.

It would be weird if there were not some positive rebalancing and some bounce in productivity, though perhaps not to the extent really needed.

It would be a surprise if the underlying trend rate of growth shifted dramatically in this period.

Conclusion

This Strategic Economic Report has considered the current conditions and prospects for the UK and SW economies. We conclude:

The UK economic recovery is real and an upturn is imminent. It is not yet, however, secure or sustained. Despite a continuing mix of tight fiscal and loose money policies, it remains vulnerable to external 'shocks', persistent deficits and other structural problems.

Compared with this national background, the SW economy currently performs quite well. But, if it is to compete successfully in the long run, it needs to rebalance aspects of supply and demand. Raised productivity, through increased investment and exports, remains the path to better real earnings and higher overall living standards.

Afterword

This is the seventh of our **Strategic Economics Report** (SER) series, summarising the state of the economy and its prospects. We update the series three times a year. The next will be released in July 2014.

The **SER** covers current trends and structural changes that are likely to interest and influence sector and spatial development in the foreseeable future. When appropriate, it also considers the broad policy environment and its likely impacts on the economic future for businesses and workers.

The **SER** aims to be brief but authoritative, using economics in a form that readers will find easy to understand and can relate to their own situation. It is offered free to all interested partners.

Those seeking more detail or extension of its themes should contact us directly to take advantage of our bespoke services for clients. Please see www.strategiceconomics.co.uk .

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