

ECONOMIC UPDATE: LEEDS CITY REGION, JULY 2017

Key points at glance

This report presents the latest assessment of the Leeds City Region economy. It sets out the recent developments in the world's leading economies, along with trends and forecasts for global growth. It analyses the recent economic performance of the UK, before considering in more detail the latest developments in Leeds City Region.

National and international headlines

- The latest Economic Outlook from the OECD points to a **modest acceleration in global growth**, from 3% in 2016 to 3.5% in 2017. Global trade is picking up and investment is increasing, though productivity and wage growth remains subdued particularly in developed nations.
- Whilst most developed economies are expected to follow global trends, the **OECD forecasts UK growth to slow to 1.6%** this year and 1% in 2018. This is broadly in line with their previous forecast, though growth this year is now expected to be 0.1% lower.
- Markets have fluctuated in recent times with uncertainty increasing after the inconclusive general election outcome. Weak consumer data has contributed to the economic slowdown.
- The **number of people in work continues to rise**, with 109,000 more people employed in the three months to April than the preceding three months and the employment rate at a record high of 74.8%
- Inflation reached 2.7% in May – its highest level for five years, whilst regular pay growth has fallen to 1.7%, its lowest level since the start of 2015. As such, **incomes are declining in real terms**.
- Average house prices are continuing to grow nationally, although have levelled off to an extent in the last year. **Nationally, average house prices are now 8 times higher than average earnings**

Key City Region and local developments

- The number of new business bank accounts opened so far in 2017 is an almost identical figure to 2016. **New business account activity has outstripped the national average so far this year.**
- **Employment in Yorkshire & Humber increased by 14,000 in the three months to April**, taking the region's employment rate to 73.5% up from 72.2% a year ago.
- **Exports from Yorkshire & Humber increased by 6.2% in Q1 2017, the fastest increase of any English region** and outpacing overall UK growth of 1.6%. The value of goods exported from the region was at its highest level in a single quarter for over 4 years.
- **Business activity in Yorkshire & Humber accelerated in May** according to the Markit/Lloyds Bank Regional PMI. The region outperformed the national picture and other Northern regions.
- The **mean house price paid in the City Region stood at £188,000 at the end of 2016, up 3.7% on a year earlier.**
- House prices in **most areas of Leeds City Region are more affordable to local residents** than in the country as a whole. As with the national picture, affordability has been an increasing issue in recent years.

Key conclusions and outlook

- The fact that labour market expansion is now being driven by the creation of full-time positions suggests that the **degree of slack in the labour market is lessening**, and issues that have been apparent since the crash, such as underemployment and weak productivity growth may beginning to ease.
- The **divergence between wage growth and inflation is accelerating**. This is one of a number of factors which now appears to be weighing on consumer confidence, along with the uncertainty created by the UK general election outcome. Concerns have been heightened by the falling savings ratio, which suggests that consumers are using savings and cheap, readily available credit to sustain spending, and have little spare capacity to cope with increasing costs.
- The **Bank of England is increasingly concerned about rising inflation**, which is now far outstripping the official 2% target. This led to the most significant split at the Bank over whether to increase interest rates since 2011.
- Official and other data emphasises that **Leeds City Region has strong existing trade relationships outside of Europe** – particularly with the US, which is a major market for the City Region's key export commodities such as medicine and pharmaceuticals. These strengths emphasise the important role the City Region is already playing in expanding trade beyond the EU.

These issues are explored in greater detail in the remainder of this document.

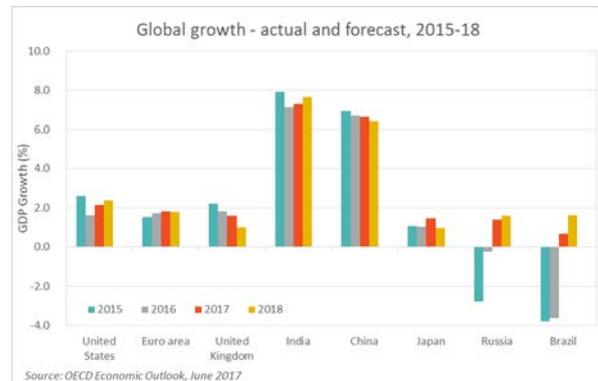
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Introduction

- This report presents the latest assessment of the Leeds City Region economy. It sets out the recent developments in the world's leading economies, along with trends and forecasts for global growth. It analyses the recent economic performance of the UK, before considering in more detail the latest developments in Leeds City Region.
- New data available includes updated global economic forecasts from the OECD, whilst new official UK data is available on the labour market to April 2017, and inflation and international trade to May 2017. Survey data also provides an update on business sentiment.
- For Leeds City Region, data on business bank accounts is available up to May, whilst further data is available on regional and sub-regional international trade. Analysis of the City Region housing market is also presented.

Global context and forecasts

- The latest Economic Outlook from the OECD points to a modest acceleration in global growth, from 3% in 2016 to 3.5% in 2017. Global trade is picking up and investment is increasing, though productivity and wage growth remains subdued particularly in developed nations.
- Whilst most developed economies are expected to follow global trends, the OECD forecasts UK growth to slow to 1.6% this year and 1% in 2018, with real incomes continuing to be squeezed by high inflation and low wage growth.
- In the USA, job creation slowed in May but was still sufficient to take the country's unemployment rate to a 16 year low. The country's manufacturing sector continues to grow at a recent pace, although expansion has slowed from its recent high. This solid data has contributed to US authorities planning to begin easing the support provided to the economy since the banking crisis in 2008. The IMF has however downgraded its outlook for the US, citing concerns about the impact of recent budget proposals.
- The Eurozone recovery continues to gather pace, with French GDP revised up, and job creation at its highest level since the financial crash. Private sector growth across the single currency area has expanded at the fastest pace in six years, according to Markit's PMI survey, whilst an IFO survey of business confidence in Germany reached a new record high.
- Elsewhere, China has continued to grow at a strong pace, with analysts expecting growth of 6.7% in Q2 compared to a year earlier, down only marginally on Q1. In India, growth slowed markedly in Q1, a move largely attributed to demonetisation moves by the government. The country's longer term outlook remains positive, however.
- Currency markets have seen a high degree of fluctuation in recent weeks. Sterling fell sharply after the inconclusive UK election, but has since recovered amid suggestions that the Bank of England could increase interest rates. The IMF's downgrade of the US outlook has led to small falls in the dollar, whilst the Euro has strengthened following French elections and positive data for the Eurozone economy.
- Oil prices have fallen in recent weeks, with output outstripping demand. Prices are now around 20% lower than at the start of 2017. Commodity prices more generally are down around 7% since the start of the year, with some foodstuffs also falling in price.



Global economy summary: The Eurozone recovery continues to gather pace, led by high levels of optimism in France and Germany. Global growth is expected to similarly strengthen over the second half of the year, though there are doubts about how proposed reforms in the US may impact the economy, and falling commodity prices are a risk for emerging nations.

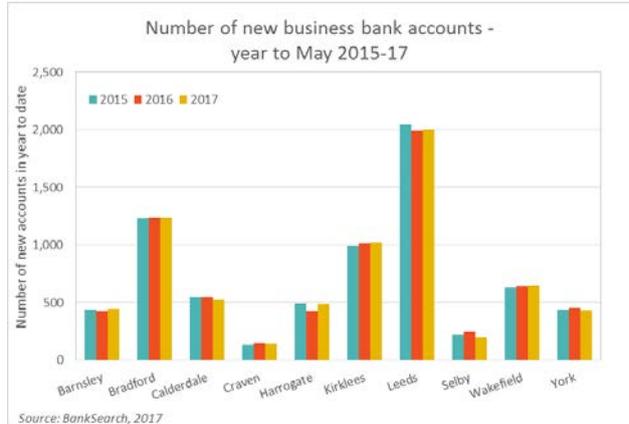
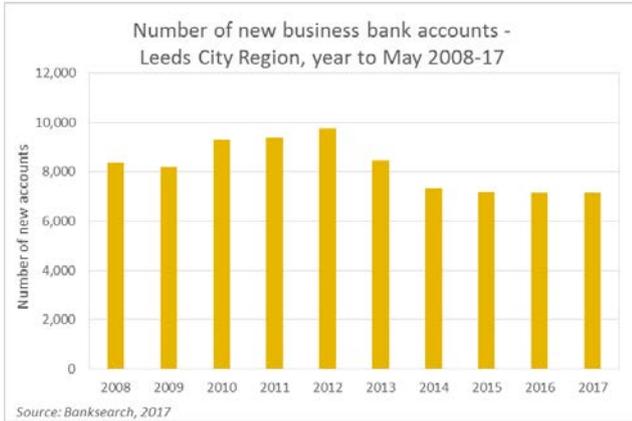
UK economic performance

Indicator	Latest position	Chart	Trend
Economic headlines	<p>UK GDP growth has been confirmed at to 0.2% in Q1 2017, its lowest level since the start of 2016 and a slowdown from 0.7% in Q4 2016. The service sector was the only area of the economy to record growth in Q1, up 0.2%. Output from production and construction was largely flat.</p> <p>Markets have fluctuated in recent times with uncertainty about the UK's approach to Brexit increasing after the inconclusive general election outcome. Weak consumer data has also increased fears that the economy is slowing.</p>	<p>UK GDP growth - 2007-17</p> <p>Source: Office for National Statistics, 2017</p>	
Confidence and sentiment	<p>Data from the Markit/CIPS PMI surveys suggests business activity continued to expand in June. Though the pace of expansion slowed for manufacturing, construction and service sector firms, it remained in positive territory. Concerns over input prices remain elevated but have eased recently.</p> <p>An Institute of Directors survey immediately after the general election found a sharp fall in confidence among IoD members with 57% pessimistic about the UK outlook, up from 37% a month earlier.</p>	<p>Purchasing Managers Index (PMI) by sector, 2016-17</p> <p>Source: Markit/CIPS PMIs, 2016-17</p>	
Labour market	<p>The number of people in work continues to rise, with 109,000 more people employed in the three months to April than the preceding three months. The employment rate is at a record high of 74.8%. 427,000 more people are working full-time than a year ago, whilst the number working part-time has declined by 54,000.</p> <p>Unemployment has fallen by 50,000 over the past three months, to 1.53 million. The unemployment rate of 4.6% is also a record low.</p>	<p>UK employment growth, 2008-17</p> <p>Source: Office for National Statistics, 2017</p>	
Trade and exports	<p>Growth in the volume of retail sales slowed to 0.6% in the three months to May. This slowdown is emphasised by a 1.2% fall in sales between April and May, whilst year on year growth is at its lowest level since 2013.</p> <p>The UK's trade deficit (the difference between exports and imports) widened to £8.6bn in the three months to April, compared to a deficit of £6.9bn in the preceding three months. Service sector exports declined, whilst some goods imports increased.</p>	<p>UK balance of trade - 2007-17</p> <p>Source: UK Trade, ONS 2017</p>	
Inflation and wages	<p>Inflation reached 2.7% in May – its highest level for five years. Increasing costs for food, energy and recreational goods all contributed to the increase.</p> <p>Regular pay growth has fallen to 1.7%, its lowest level since the start of 2015. As such, incomes are declining in real terms and are expected to continue to do so in the near term with inflation forecast to exceed 3%.</p>	<p>Wage growth and inflation, 2008-17</p> <p>Source: Office for National Statistics, 2017</p>	

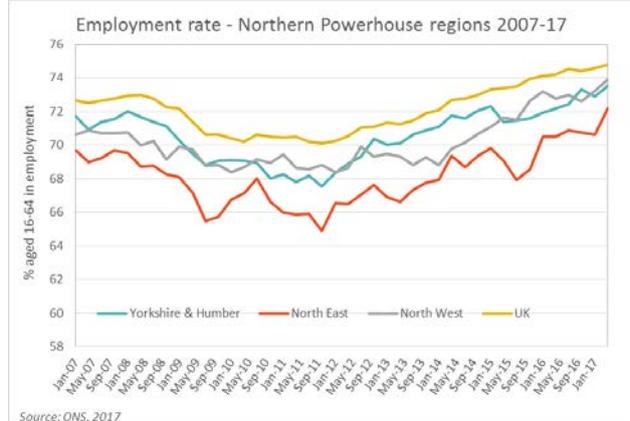
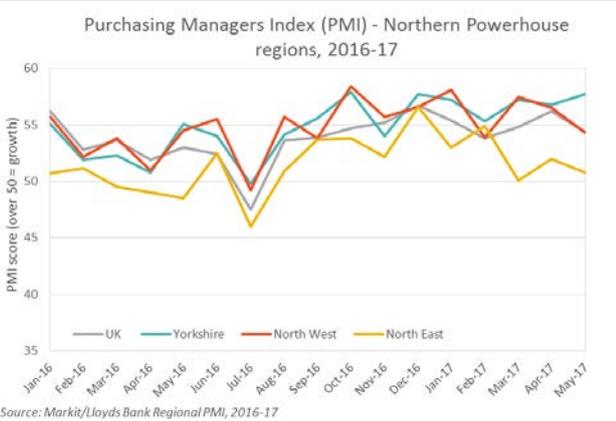
UK economy summary: The employment picture remains healthy in the UK, and businesses report that activity continues to expand at a solid pace. Recent growth has largely been driven by consumer spending, though high inflation, lower wage growth and uncertain post-general election appear to be weighing on consumer confidence.

Leeds City Region – Business Performance and Labour Market

- The number of new business bank accounts opened in Leeds City Region rebounded in May. 1,440 new accounts were opened in May, broadly in line with May 2016 and up 11.5% from April's low. 7,150 new accounts have been opened in Leeds City Region so far in 2017, an almost identical figure to 2016. This compares to a 2.5% fall in new accounts opened nationally, and ranks the City Region 8th out of 38 LEPs.
- At district level, Harrogate (+15.8%), and Barnsley (3.5%) have seen the fastest increases so far this year, whilst the number of new accounts is down on last year in Calderdale, Craven, Selby and York.



- Business activity in Yorkshire & Humber accelerated in May according to the Markit/Lloyds Bank Regional PMI. The region's PMI of 57.7 is above the UK reading of 54.4, suggesting activity expanding at a more rapid pace locally than nationally (a reading of above 50 represents growth). The Yorkshire & Humber PMI is higher than other northern regions, each of which saw slowing growth in May, and Yorkshire is second only to East Midlands among UK regions.



- Employment in Yorkshire & Humber increased by 14,000 in the three months to April, taking the region's employment rate to 73.5% up from 72.2% a year ago. The rate is below that of the UK (74.8%), but higher than the North East (72.2%) and similar to the North West (73.9%).

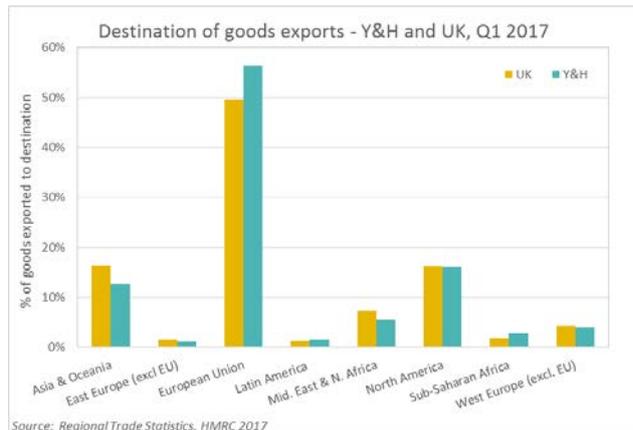
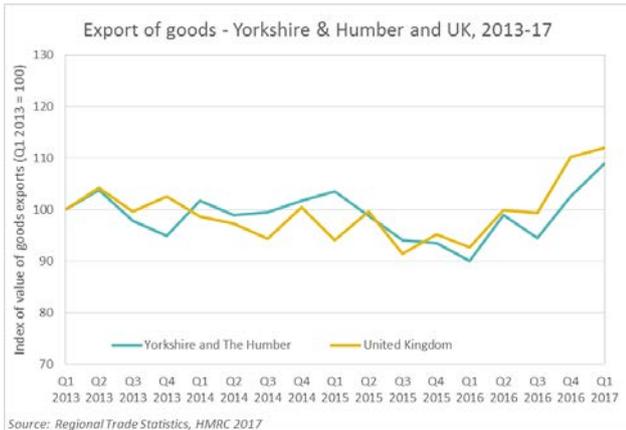
Summary: Business activity in Leeds City Region remains solid, with new business bank accounts suggesting business formation is on a par with the same period in recent years. The Yorkshire & Humber region has performed well in recent months compared to other Northern regions and the UK as a whole with regard to business activity and employment growth.



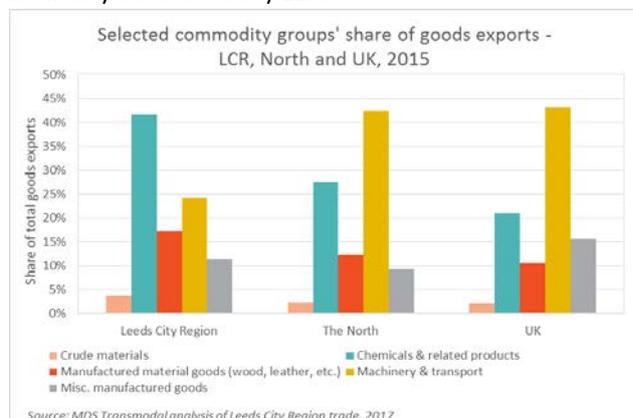
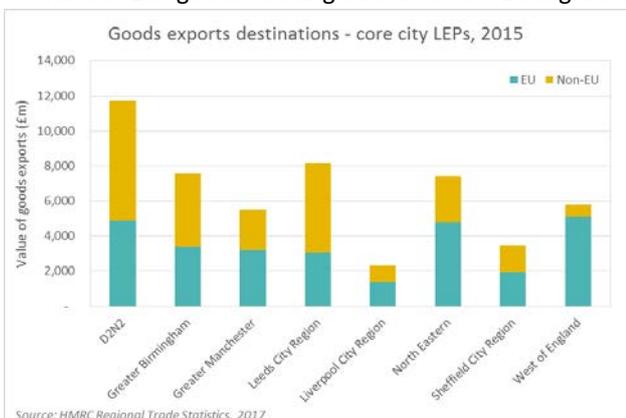
Leeds City Region – Trade, exports and investment

- A recently-commissioned study of export activity in Leeds City Region carried out by MDS Transmodal has identified a number of key export strengths and opportunities for the City Region which help to explain Leeds City Region's strong export links with the US. The work suggests around 25% of the City Region's goods exports are accounted for by pharmaceutical and medical products. The US is by far the biggest market for this commodity, accounting for around £2bn of the £2.5bn of pharma goods exported from LCR in 2015.
- Other key export commodities identified in the research include chemicals, accounting for 9% of LCR exports compared to a 3.5% share nationally and worth £875m in LCR in 2015. General industrial equipment and machinery accounted for a similar share of LCR exports, also exceeding their 4.8% national share.
- The study supports the HMRC findings that the US is already a key export market for Leeds City Region, though the EU remains a significant trading partner, and the City Region remains relatively under-exposed to Asian markets.

- The Yorkshire & Humber region exported goods worth £3.9bn in Q1 2017, according to HMRC's Regional Trade Statistics. This is the highest value of goods exported from the region in a single quarter for over 4 years. This is an increase of 6.2% on Q4 2016, the fastest increase of any English region and outpacing overall UK growth of 1.6%. The value of goods exports from the region is 21% higher than a year ago, a rate of change similar to the UK as a whole.
- The destination of the region's goods exports has remained relatively static of late, with the EU as the largest market for Yorkshire & Humber goods exports accounting for 56% of the region's exports by value in Q1 2017. 16% of goods headed to North America, and around 13% went to Asia & Oceania. The picture in the region is similar to that of the UK, though Yorkshire & Humber tends to be more reliant on the EU as an export market, and slightly under-represented in Asia and the Middle East.



- Additional analysis carried out by HMRC at LEP level, suggests that the EU only accounts for 38% of goods exports from Leeds City Region, with over 60% of LCR exports heading outside of the single market. The US is by far the largest single trading partner on this analysis, accounting for 33% of LCR goods exports in 2015, followed by Germany (7%) and France (5%). This suggests Leeds City Region is less reliant on the EU as an export market than the rest of the Yorkshire & Humber region. The City Region's strong performance on exports to the US also means that the share of LCR goods heading outside of the EU is greater than in any other core city LEP.

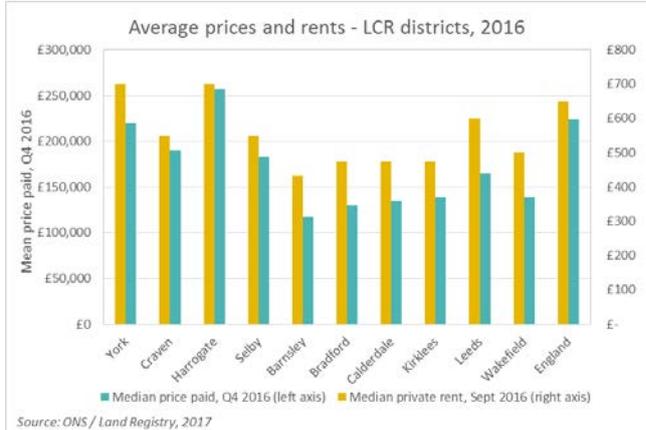
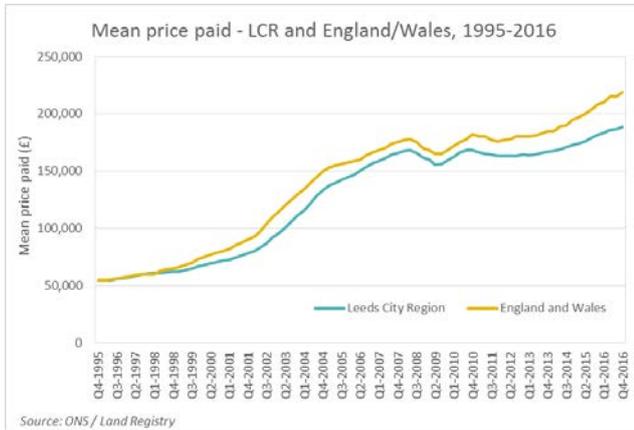


Summary: Goods exports from Yorkshire & Humber increased faster than any other English region between Q4 2016 and Q1 2017, though the data can be subject to substantial fluctuation. Further work has identified medicinal products and pharmaceuticals as important export commodities for the City Region, with the US as a key market.

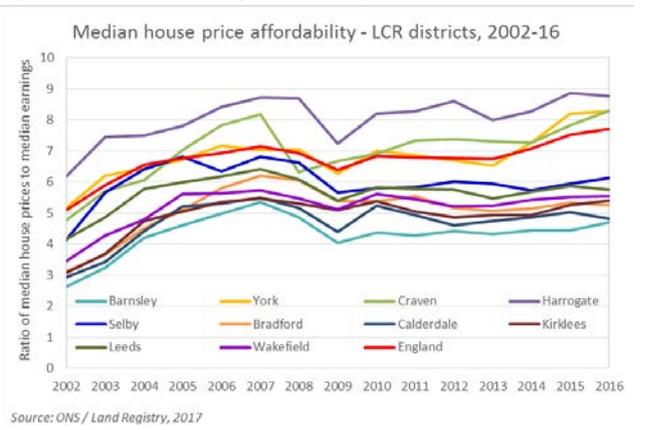
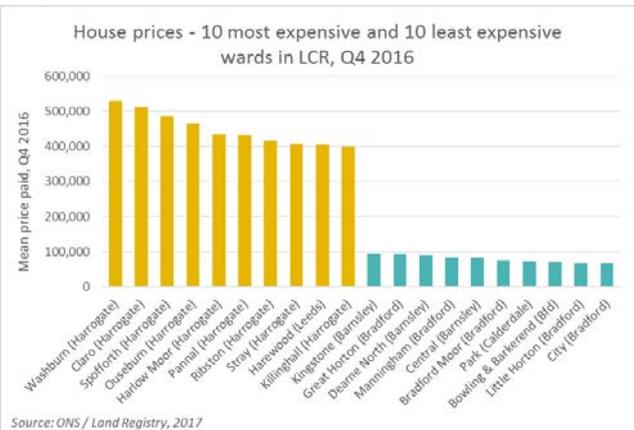


In Focus: Leeds City Region housing market and affordability

- The mean house price paid in the City Region stood at £188,000 at the end of 2016, up 3.7% on a year earlier. Local prices have broadly followed the national picture, though local prices and national averages have been increasingly diverging since 2009. Prices in England and Wales increased by 5.3% across 2016, to an average of £219,000.
- Highest house prices are to be found in areas such as Harrogate (where prices are above the national average), as well as York, Craven and Selby. Lower house price areas tend to be in the south of the City Region. This pattern is largely replicated in terms of private sector rental values.



- 9 of the 10 wards with the highest house prices in Leeds City Region are in Harrogate, with Harewood in Leeds the only other ward to make the top 10. Average prices are around £400,000 or above in these wards. The 10 wards with the lowest prices all have average costs below £100,000 and are largely dispersed between Bradford and Barnsley although Park ward in Calderdale also makes the list.
- Resident incomes across the LCR also reflect these spatial patterns, but have not risen at the same rate as house prices (and rents to a lesser extent). As a result affordability has been worsening in recent years.



- In 2002, only Harrogate had a higher affordability ratio than the England as whole. Median prices in Harrogate were 6.2 times average earnings, compared to an average across England of 5.1. York was broadly in line with England, with other areas of the City Region relatively more affordable, with prices 2.6 times earnings in Barnsley, 4 times in Leeds and around 3 times in the rest of West Yorkshire.
- In all areas of the City Region, affordability was worsening in the years before the downturn. The crash and subsequent fall in house prices helped to stall this, though affordability ratios remained substantially higher than they had been in 2002. Post-recession, affordability ratios have been increasing (worsening) again in England, and in the North Yorkshire areas of LCR. Other parts of the City Region have remained relatively stable since 2009.
- By 2016, affordability ratios were higher than the national average of 7.7 in Harrogate (8.8), York and Craven (both 8.3). Barnsley (4.7) and Calderdale (4.8) are the most affordable areas, with prices elsewhere in West Yorkshire around 5.5 times average earnings.
- Similar patterns are visible when looking at ratios of lower quartile earnings and house prices. Lower quartile house prices are more than 8 times lower quartile earnings in Harrogate and York, but below 5 times in Barnsley, Bradford and Calderdale, meaning the cheapest 25% of properties are relatively more affordable to those on lower incomes.

Summary: House prices in Leeds City Region are generally below the national average, and in most areas are more affordable to local residents than in the country as a whole. As with the national picture, affordability has been an increasing issue in recent years, and there are hotspots in the City Region where prices and affordability outstrip the national average.



Conclusions and outlook

- Survey data suggests that the UK economy remains continues to expand, with activity increasing across all areas of the economy. However, the pace of expansion has slowed in recent months as the election and other issues contribute to increasing uncertainty with evidence that businesses are delaying investment decisions.
- Official labour market data remains positive, with employment continuing to reach new record highs. The fact that expansion is now being driven by the creation of full-time positions suggests that the degree of slack in the labour market is lessening, and issues that have been apparent since the crash, such as underemployment, may be beginning to abate.
- A tightening of the labour market could also, in time, contribute to addressing one of the other key challenges facing the economy – low productivity. One theory on why productivity growth has stalled is that easy access to labour has provided firms with a cheap method of meeting increasing demand. As such labour becomes harder to come by, companies may increase capital investment in order to improve productivity and meet demand.
- However, there are also some significant headwinds forming, and the fact that UK growth has been revised down to 0.2% in Q1 confirms a slowdown is underway. Furthermore, that growth was entirely driven by the service sector, indicating that relatively strong recent export performance has had limited impact on the economy as a whole.
- The latest data shows that the divergence between wage growth and inflation is accelerating. This is one of a number of factors which now appears to be weighing on consumer confidence, along with the uncertainty created by the UK general election outcome. Service sector growth has been largely driven by consumer demand, so clearly any slowdown in this area is likely to be keenly felt.
- The Bank of England is increasingly concerned about rising inflation, which is now far outstripping the official 2% target. This led to the most significant split at the Bank over whether to increase interest rates since 2011. Concerns have been heightened by the falling savings ratio, which suggests that consumers are using savings and cheap, readily available credit to sustain spending, and have little spare capacity to cope with increasing costs.
- The Bank has previously said it is willing to “look through” higher inflation, in part because it is largely driven by external factors, such as the fall in the value of sterling post-EU referendum, and partly due to concerns that increasing interest rates would harm households who are already struggling with subdued wage growth. However, some now expect wages to begin to increase now that the labour market is tightening, and a rise in increase rates could be justified to keep inflation in check.
- The pound has been increasingly volatile since the UK election, though it has recently rebounded to around £1.30 against the dollar. Any further increase could help mitigate further rises in inflation, as could the recent fall in oil prices. Survey data suggests that businesses’ concerns over import costs, whilst still elevated, have eased recently.
- Whilst new local data is relatively limited for this update, that which is available suggests the City Region is performing well against the national economy. Levels of business activity are above the national average and comparable to pre-referendum levels, according to data from BankSearch and the Lloyds Regional PMI.
- Export data for Yorkshire & Humber is also largely positive, although this data can be somewhat erratic so quarterly fluctuations should be treated with caution. Additional analysis by HMRC, along with locally commissioned work carried out by MDS Transmodal, is helping to substantially improve our understanding of exports from Leeds City Region. This work points to some clearly defined strengths for the City Region in export terms, most notably medicinal and pharmaceutical products.
- This research also highlights opportunities for the City Region to increase its export activity in new markets, most notably Asia, but also emphasises that the City Region has strong existing trade relationships outside of Europe – particularly with the US, which is a major market for the City Region’s key export commodities outlined above. These strengths emphasise the important role the City Region is already playing in expanding trade beyond the EU.
- However, it should also be noted that estimates of export destinations do not account for relationships between local firms in the supply chains of original equipment manufacturers (OEMs) elsewhere in the UK who then export finished goods to the EU. As such, estimates of export activity could underestimate exposure to the EU.

This briefing has been produced by the Regional Economic Intelligence Unit. Any comments or queries can be addressed to reiu@westyorks-ca.gov.uk