## EY's UK Regional Economic Forecast

Our reports provide the latest UK economic forecast and examine the current economic trends and outlook for the next three years in regions and cities across the UK. They represent a detailed and directly comparable analysis of UK economic performance at a regional and city level. This report is part of our Economics for Business programme, which provides knowledge, analysis and insight to help businesses understand the economic environments in which they operate.

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We are very pleased to share our third annual report which monitors the economic performance of the UK regions, devolved administrations and cities in England and Wales. EY’s Scottish ITEM Club 2018 Forecast (December 2017) analyses the economic performance of Scotland and its cities in greater detail.

The role of regions in driving UK-wide balanced growth has never been more important and the recent Industrial Strategy is both positive and welcome as the Government signals further commitment to boosting productivity across the whole country.

It is disappointing however, to find that, in the three years since our first regional forecast, very little progress has been made to reduce geographic imbalances between the South of England and the rest of the country.

Whilst there are some positive and encouraging signs in some areas, our findings show that we must acknowledge that rebalancing is a more significant and complex challenge than considered to date and requires radical thinking. We at EY look forward to supporting and helping in that process.
Executive summary

Rebalancing – still a long way to go

No sign of any decline in geographic imbalances ...

In the three years since our first regional economic forecast, little progress has been made to reduce geographic imbalances between the South and the rest of the country. In fact there has been a slight increase in the imbalance as measured by shares of Gross Value Added (GVA). We expect little change in the next three years, with a slightly slower rate of increasing imbalance. However, as this slowing is due primarily to a slowdown in the economy overall, and especially in the fastest-growing sectors that are more important in the southern regions of the country, this is not something to celebrate.

... though some reasons for optimism ...

There are some bright spots. Manchester’s robust performance in recent years shows what can be achieved with the right focus and resources. Equally, the performance of fast-growing Reading, Cambridge and other cities demonstrates that UK cities can prosper in the modern knowledge-based economy.
Our analysis of relative city performance provides an insight into how policy and different industrial structures influence economic performance. The strength of a city in professional services and information and communications technology (ICT) explains the majority of the differences in growth rates achieved over the last three years.

**... but more concerns too ...**

The success of Manchester and the fast-growing southern cities highlights another challenge: the power of cities, especially the larger ones. When we compare our regional forecasts it is clear that the strong are getting stronger. City growth, especially for large cities, typically outpaces regional growth which means that the towns and other areas within regions are growing more slowly. Geographic imbalances exist within regions as well as between them and these local disparities are proving the most challenging to address.

**... so time for a new push from the bottom up.**

The Government has just published its proposals for the UK’s Industrial Strategy. We see this as an extremely positive development. It is also opportune, the world economy is changing and the UK has a once in a generation opportunity to reposition itself in a world of changing trade dynamics and technology led disruption.

We have highlighted the central role of sectors as a key driver of local economic outcomes. The Industrial Strategy recognises the role of sectors but really only scratches the surface by identifying a small number of sector deals. These initial deals need to be quickly extended to a wider range of sectors. If we are serious about geographic rebalancing, we need a manufacturing strategy that goes beyond deals announced so far. The automotive resurgence in the Midlands shows what is possible, and other capital intensive industries, such as, machinery, electronics, food and drink and chemicals all offer the opportunities to boost exports and to substitute imports and support growth outside of the core cities.
The sector plans are just one area requiring further ambition. Other elements of policy must be designed to complement the Industrial Strategy. The key components of this policy should be:

- **Devolution of economic policy making** to make the increased support for Local Enterprise Partnerships (LEPs) set out in the Industrial Strategy a reality.

- A commitment to **deliver infrastructure** that has to go beyond the welcome first steps in the Industrial Strategy.

- Investment in the **skills** required to build a successful modern digital economy that can compete on the world stage.

- A **regional trade strategy** which links all the elements of UK trade in the context of the industrial strategy.

Most importantly, we must acknowledge that rebalancing is a more significant challenge than considered to date. As identified above, imbalances exist at a local level as well as at the national level. Policy to date has concentrated on the core cities and national initiatives in the main but we need a bottom up approach to run in parallel with this, with the explicit aim of raising the level and quality of economic activity in the weakest parts of the economy, the UK’s small cities and towns.

This will require radical thinking. How can we stimulate activity in disconnected parts of the economy? Co-ordination with top down activity is required such as working to identify which parts of supply chains we can encourage to locate outside of the large cities. But we need to do more. Can we identify and support entrepreneurs in the UK’s towns and cities or tempt new entrepreneurs to these areas?

**No time to waste.**

These are challenging and uncertain times for the UK economy but we need to respond by setting out our future vision and working towards this. The performance of Manchester shows what policy can do, the West Midlands highlights the potential of manufacturing, and cities such as Reading and Cambridge show that we can thrive in the knowledge-based economy of the future. We must learn from success and work harder to create opportunity in the weaker and more remote parts of the country.
A slowing UK economy ...

The UK economy has changed significantly since we first published our region and city forecast in 2015. As the recent EY ITEM Club Autumn Forecast (October 2017) set out, the fall in the value of the pound and the decline in business confidence following the referendum on the UK’s membership of the European Union (EU) have put pressure on both consumer and business spending, leading to a slowing of UK growth.

While the UK has slowed, the global economy has accelerated and this has led to some pick up in export performance, albeit less than we may have expected given the more competitive pound. Taking the above factors into account and noting that the Chancellor provided a modest boost to activity in his Autumn Budget, EY ITEM Club forecast that UK GDP will expand by just 1.4% in 2018 and 1.8% in 2019.

**UK: Contributions to GDP growth**

Source: EY, EY ITEM Club
... amid a backdrop of uncertainty ...

The negotiations on the UK’s exit from the EU are creating significant uncertainty for businesses regarding the future nature of regulation, trade and migration policy between the UK and the EU. EY ITEM Club’s forecasts assume the UK will conclude a transition agreement with the EU before the end of 2018, providing some degree of certainty to businesses as they evaluate their investment decisions in the UK.

The Government recognises the challenges facing the economy and has now published its white paper setting out its thoughts on an Industrial Strategy for the UK. This seeks to provide a framework for long-term business decision-making and so offset some of the uncertainties related to the nature of the UK economy after Brexit. Improving growth across the whole of the UK is one of the core objectives of the Industrial Strategy and will be an important influence on the future performance of the regions and the cities of England and Wales.

... has already impacted the regions ...

As we found in our previous two reports, London and the South East have been the fastest-growing regions in the UK economy and are expected to have grown by 2.13% and 2.2% respectively between 2014 and 2017. Both the North West and South West have performed strongly since 2014, narrowing the gap with the regions that were previously fastest growing. The North West benefitted from its diversified economy with all sectors performing strongly, while service sectors, including a strong boost from ICT, drove growth in the South West.

The East of the country and the West Midlands are also expected to grow in excess of the national average rate between 2014 and 2017, driven by their specific regional sector strengths. The East achieved much faster growth in knowledge-based industries than the UK overall, and in the West Midlands, manufacturing and logistics both contributed to growth in the region at a level more than double the national average.
Looking forward, we expect that growth overall will be slightly lower but London and the South East will continue to outperform all other UK regions through to 2020, with their growth averaging 2.1% compared to UK average annual gross value added (GVA) growth of 1.79%. This represents a slight narrowing of their lead over the average UK growth rate as they are forecast to grow at an average annual rate of 2.1% to the end of 2017, compared to 1.83% for the country as a whole.

The East and the West Midlands will continue to perform relatively well but we expect the North West and South West to slip back towards the pack in the period up to 2020. Encouragingly, the slowest-growing regions in the last three years, Wales, the North East, Yorkshire & Humberside and the East Midlands, will all grow faster to 2020 than in the previous three-year period according to our forecast.
... but there will be no acceleration in rebalancing.

Slower growth in London and the South East does not have a silver lining for the rest of the country. Despite the bunching of growth rates across the regions, the gap with London and the South East will not close but at least the rate of increase in disparity will slow. In fact, the four fastest-growing regions will be the four most southerly ones, London, the South East, the South West and the East. The UK will be more unbalanced between the North and the South in 2020 than it is today, according to our forecast. To understand the drivers of relative geographic performance to 2020 in more detail, we now turn to our analysis of the cities of England and Wales.

EY English rebalancing index 2010-20

Index of imbalance
(1 = no imbalance)

Balance in favour of the South

Balance in favour of the North

Source: EY ITEM Club
The overall picture of the growth of cities in England and Wales from 2014 to the end of 2017 is expected to be a familiar one: cities in southern England are set to outperform the rest. Reading once again tops the growth league with average annual GVA growth of 3.83% and Cambridge, Milton Keynes and Exeter all make the top five.

Cities in the north of England and in the Midlands have mostly grown more slowly than the average, with the notable exceptions of Manchester, which continues to build on its diverse economy, and Newcastle, catching up after years of slower growth. By contrast, the Tees Valley, Sunderland, Hull, Sheffield and others have found conditions difficult.

**City GVA growth 2014-17 and 2017-20**

Source: EY ITEM Club
The broad story on employment growth is very similar to that for GVA, with cities in the south of the UK achieving higher rates of employment growth. The mix of growth by sector affects the relationship between GVA and jobs growth. Cambridge and Reading, with their strengths in high value-added sectors, create fewer jobs per unit of output whereas Milton Keynes and Manchester had broader mixes of growth sectors.

... with no significant change expected ...

Our forecast is for a reduction in the differences in the rate of economic growth between northern and southern cities in the period up to 2020. As this is primarily driven by a faster slowing in the south than an acceleration of growth in the north, it is not really to be celebrated. Moreover, as with the regions, there is no narrowing of the geographic imbalance, just a slowdown in the rate of widening disparity.

City employment growth 2014–17 and 2017–20
The disparity between regions is forecast to be more significant in the next three years for employment creation. The relative strengths of northern and Midlands cities in manufacturing and the greater role played by the public sector in these areas will limit the rate of job creation. Manufacturing in particular will grow in output terms but see a fall in employment as technology is used to boost productivity.

... illustrating both the opportunity and challenge ...

The analysis of relative city performance provides real insight into how policy and different industrial structures influence economic performance. As shown below, the strength of a city in professional services and ICT explains the majority of the differences in growth rates.

GVA growth and share of professional services and ICT

Source: EY ITEM Club
By contrast, manufacturing is negatively correlated with GVA growth. Cities with a strong manufacturing base find their expansion limited by the relatively slow growth of manufacturing compared to the services sector.

The performance of Reading, Cambridge and several other southern cities illustrates the importance of sectors in determining performance in the short- to medium-term. We forecast that the GVA of information and communications...
and professional services will grow by 3.5% and 3.4% annually, respectively, over the next three years. By contrast, manufacturing will only grow by 1% over the period. This translates into strong performance for Reading, where the information and communications sector accounts for more than twice as large a share of GVA as the national average, and Cambridge, where professional services account for 50% more of local GVA than the national average share. Over 50% of Cambridge’s growth in the next three years is forecast to come from ICT and professional services.

But it is also clear that location is not a binding constraint on growth. The strong GVA performance – both historic and projected – for Manchester reflects the substantial investments made over more than a decade in revitalising the city centre and the surrounding business infrastructure. This has allowed the city to strengthen and diversify its local economy and ensure it can capture growth waves and avoid being overexposed to a slowdown in a single sector.

However, the success of Manchester and the strong southern cities highlights another challenge – the power of cities, especially the larger ones. When we compare our regional forecasts it is clear that the strong are getting stronger. City growth typically outpaces regional growth which means that the towns and other areas within regions are growing more slowly. Geographic rebalancing is as important within regions as between them.

This is an opportunity for geographic rebalancing to an extent but it is also a potential issue as it risks a concentration of activity in a small number of stronger cities. The national approach to geographic rebalancing must identify how to ensure that smaller cities and towns, and the more remote parts of regions, can benefit from the success of the faster-growing cities. Improved connectivity, both physical and digital, will be critical in ensuring the economy is one in which everyone has a chance to participate fully, regardless of location.
EY recently met with the Centre For Towns to discuss how sub-regional disparities are an increasingly significant problem. The Centre has found that whilst core cities such as London, Manchester, Cardiff, Edinburgh, Nottingham and Bristol serve as a magnet for young, high-skilled populations the opposite is the case for small and medium-sized towns across the UK. In those towns the numbers of working-age people has fallen for over three decades; falls which have been more than offset by increasing numbers of elderly people. The net result is a natural ‘ageing’ of small and medium sized towns across the country, a process which exacerbates the disparities in productivity between our towns and cities within our regions. EY and the Centre For Towns hope to pursue this research further in order to understand how we improve the productivity in small and medium-sized towns.

@centrefortowns
The UK is trying to rebalance its economy ...

As the most recent UK forecasts by both the EY ITEM Club and the Office for Budget Responsibility (OBR) make clear, the UK economy is entering a challenging period as we prepare to leave the EU. This means that the case for driving geographic rebalancing to maximise the potential of all the UK’s regions and cities, moving the country to a higher sustainable rate of economic growth, is stronger than ever. Brexit makes this policy even more important both to maximise growth but also to support the UK’s transformation to be in a position to prosper after Brexit.

... but it is proving very difficult to achieve ...

In this context, we believe our economic forecasts for the UK’s regions and cities provide a lot of food for thought – not least for Government policymakers seeking to stimulate a faster and more balanced pattern of growth across the UK, and for local, regional and city authorities seeking to claim their fair share of that growth. Our projection is that the North-South divide is set to widen very slightly over the next three years. The potential of targeted initiatives is clear but at the current pace, the drive for rebalancing will take years to have a noticeable impact.
... so time for a new push ...

The Government has just published its proposals for the UK’s Industrial Strategy. We see this as an extremely positive development. It is also opportune, as the world economy is changing and the UK has a once in a generation opportunity to reposition itself in a world of changing trade dynamics and technology-led disruption.

... with sectors to the fore ...

This report has demonstrated how sectors are a key driver of economic outcomes and we are cheered by the identification of sector initiatives in the Industrial Strategy. The focus on productivity is sensible and the aim of transforming the economy to meet the challenges of global megatrends is also welcome.

At the sector level, the initial sector deals need to be extended to a wider range of sectors very quickly. As priorities:

► Manufacturing remains a key element of the economy of many regions and cities of the UK, especially outside of the South East – the resurgence in the Midlands shows what is possible and other capital-intensive industries such as machinery, electronics, food and drink, and chemicals all offer opportunities to boost exports and to substitute imports, something that is more urgent following the fall in the value of sterling.

► It is clear that technology will be a key component of UK growth both within the information and communication sectors but also more broadly across other sectors of the economy and especially advanced manufacturing. Support for artificial intelligence is a good first step but a broader approach to digital sectors to include, among others, virtual reality, fintech, analytics and 3D printing is essential.

► The Industrial Strategy identifies health and clean energy as challenges but the scale of response appears some way short of that required to address such transformational activities. Once again, these are critical areas for rebalancing the economy.
... within a wider policy response ...
The sector plans are just one area requiring attention. Other elements of policy must be designed to complement the industrial and regional strategy. The key components of this policy will be:

► **Devolution of economic policymaking** to make the increased support for Local Enterprise Partnerships (LEPs) set out in the Industrial Strategy a reality. If policy is to succeed it needs to be integrated and this means that more control and resource for skills and education, housing, infrastructure, transport and health care needs to be devolved to the local level.

► A commitment to **deliver infrastructure** that has to go beyond the welcome first steps in the Industrial Strategy. A cross-country rail and road network fit for purpose in the North and Midlands are essential requirements. Broadband and mobile access also need to be upgraded much more significantly and faster than provided for in the white paper to ensure all parts of the country are connected so that people can participate fully in the economy.

► Investment in the **skills** required to build a successful modern economy that is competing on the world stage. Digital skills will be a key part of this but so will the communications and interpersonal skills that employers value so highly.

► **A regional trade strategy** which links all the elements of UK trade in the context of the Industrial Strategy. The UK’s post-Brexit trade deals must guarantee access to the right markets for the right products and enable imports to the UK.

► The appropriate **policy and incentive regime** to allow the UK to reposition itself in existing markets and to create a platform for growth in new sectors. This should include further incentives for investment in R&D, tax and business rate schemes that incentivise capital investment, support for supply chain realignment and other initiatives such as using public procurement to de-risk corporate decision-making in an uncertain and challenging economic environment.
... commensurate with the scale of the challenge.

The UK has to view geographic rebalancing as a key component in the process of transforming the economy. We should not underestimate the scale of the challenge. As the recent *EY ITEM Club: special report on business investment* identified, the UK has underinvested relative to our peers for a long period of time. With the requirements to prepare for Brexit, position for technological change and maintain our competitiveness, we need to invest more than we have done for some time. To achieve a level of business investment that puts the UK around the G7 average will require an increase of around £50 billion a year. The Industrial Strategy is a good first step, but more public resources will be required to create the economic platform necessary to stimulate the required level of business capital spending.
Notes on data and forecast assumptions

The forecasts presented within this report are produced using the Oxford Economics Local Authority District Forecasting Model but are fully consistent with the EY ITEM Club Autumn Forecast (October 2017).

The forecasts depend essentially upon three factors:

► National outlooks.

► Historical trends in an area augmented by local knowledge and understanding of patterns of economic development built up over decades of expertise.

► Fundamental economic relationships which interlink the various elements of the outlook.

The forecasts are demand-based and assume no supply-side constants. They also assume the continuation of existing Government policies, and those currently announced. While the UK Government does not have a specific regional policy, some enterprise support is allocated locally, and infrastructure decisions clearly have regional implications. The devolved administrations have their own responsibilities in these areas, which cause some differences in policies and priorities.

Key data definitions include:

► Total employment is jobs-based and includes employees in employment, the self-employed, Her Majesty’s Forces and government-supported trainees.

► GVA data is presented in 2015 prices and excludes output from the ‘extra region’ i.e., the contribution from North Sea oil and gas extraction, UK embassies abroad and UK forces stationed overseas. The latter are included in the GDP definition used in the EY macroeconomic forecasts.

► Labour force unemployment is the official unemployment measure and refers to the number of jobless people who want to work, are available to work and are actively seeking employment.
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Stirling Stirling CA
Sheffield City Region
Sheffield City Region Combined Authority
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  Dales LA, Doncaster LA, North East Derbyshire LA, Rotherham LA,
  Sheffield LA
Portsmouth Portsmouth UA
Oxford Oxford LA
East Anglia East Anglia Combined Authority
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Tees Valley Combined Authority
Middlesbrough UA, Hartlepool UA, Redcar and Cleveland UA, Stockton-on-Tees UA, Darlington UA

Liverpool City Region Combined Authority
Halton LA, Knowsley LA, Liverpool LA, Sefton LA, St Helens LA, Wirral LA

Cardiff
Cardiff LA

Milton Keynes
Milton Keynes UA

Swansea
Swansea LA

Sunderland
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Cornwall
Cornwall UA

West Midlands Combined Authority
Birmingham LA, Coventry LA, Dudley LA, Sandwell LA, Solihull LA, Walsall LA, Wolverhampton LA

Greater Manchester
Manchester LA, Stockport LA, Tameside LA, Oldham LA, Rochdale LA, Bury LA, Bolton LA, Wigan LA, Salford LA, Trafford LA

UA = Unitary Authority
LA = Local Authority District
CA = Council Area
LGD = Local Government District
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