# EY ITEM Club

## UK Regional Economic Forecast

**February 2023**


Building a better working world

# Contents



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# Foreword

## EY UK Regional Economic Forecast

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We are delighted to welcome you to our eighth regional economic forecast for the UK. The challenge regarding relative economic performance across the nations and regions of the UK remains as relevant as ever, particularly in the context of a difficult economic outlook for 2023. EY, as a nationwide employer, remains committed to supporting efforts to rebalance the country's economic geography, and we develop our forecasts with the goal of helping to broaden understanding and advance the debate. We will be working with our colleagues across the country to share more of our detailed findings with local stakeholders.

The year 2022 was difficult for the UK and the aspirations for economic growth for the regions. It feels like a long time ago now, but the year started with some optimism; COVID-19 was apparently behind us, and it looked as though both business and consumers would face the first 'normal' year since 2019. The Russian invasion of Ukraine quickly ended that optimism. The impact of the invasion on commodity prices, most obviously oil and gas, fuelled inflationary forces already underway, leading to the worst inflationary crisis in the US and Europe since the 1970s. The consequences – shrinking real incomes, pressure on margins and synchronised and rapid increases in interest rates – brought UK economic growth to a standstill, and a mild recession is expected for 2023. However, growth is expected to return in 2024, as inflationary pressures ease, and even in a general downturn there will always be opportunities for businesses to take advantage of wider global trends to drive regional growth.

The forecasts suggest that London, and to the lesser extent the wider South East, will remain the economic powerhouses of the UK economy, leading the recovery in 2024. Whilst this is good for UK growth as a whole, given the importance of London's economy, it does mean that the long term gap between London and the rest of the country is set to widen further in the coming years, reverting to pre-pandemic trends. This is driven in large part to the benefits the capital enjoys as a financial hub, its strengths in other high-growth sectors, and beneficial demographics such as its relatively young and growing population.

In this context, economic levelling up is battling against the tide of existing sectoral compositions in different regions, the migration of the working-age population and differing levels of skills attainment. These factors are deeply rooted structural dynamics that will take time to adjust. The challenge for policy makers is perhaps how best to leverage London's strengths for the benefit of the wider economy, to seed, finance and scale high-value-add, high-growth sectors across the regions and nations of the UK. There are a number of potential opportunities – from the drive to net zero, rapid developments in technology, reconfiguration of global supply chains – all of which are potential drivers of growth for the UK as a whole, and for its individual nations and regions.

Adopting a broader view of what attracts people and businesses to a region can help: tackling issues that affect quality of life – ranging from public services to sense of place – can tip the balance further in favour of those parts of the UK where the growth prospects are currently lower but support sustainable employment opportunities. Such actions will mean cities and towns are better equipped to attract and retain people who can contribute to future prosperity.

Therefore, despite challenging economic headwinds, there are grounds for optimism and we remain committed to the balancing of geographical prosperity within the UK, as well as supporting efforts to maximise the potential and performance of all parts of the country. We hope you will continue to engage with us as we share and develop our ideas with you throughout 2023 and into the future.

# Executive summary

## A shallow economic downturn and geopolitical events are centre stage for 2023 …

Since our last Regional Economic Forecast, the UK economy has been shaken by a series of global and national events, including the war in Ukraine, surging energy prices, increased borrowing costs, political uncertainty, and a generally gloomier global economic outlook. The EY ITEM club now thinks the UK economy will fall into a recession this year and that GDP will decline until mid-2023. However, this will be a relatively mild recession by historical standards, with the economy expected to recover in 2024, as inflationary forces start to fade.

## … as London, Scotland, and the East of England led the country's recovery out of the pandemic in 2022, with the capital resuming its economic dominance.

There has a been a notable return to pre-COVID-19 trends in regional economic growth, with London outperforming the rest of the UK. Whilst recovery has been slower outside of the capital, there are positive signs of other regions returning to, or outstripping, pre-pandemic levels.

## The jobs market has remained robust, although inactivity is a challenge …

Unemployment has fallen to historic lows, vacancies are at record highs, and hiring has continued apace. However, growth has been restrained by a labour market that has still to fully recovery from the after-effects of the pandemic. The portion of the working age population that are economically inactive has risen, largely down to an increase in students (beneficial longer term), and those with long term health issues (much more challenging to address). This rise in inactivity is one of the most significant challenges facing policy makers nationally and regionally, particularly as the population ages.

## … and the UK faces a shallow recession in 2023 due to inflation-driven squeeze on real incomes, the impact of which will vary by region.

Higher inflation is squeezing real incomes, which will drive a contraction in the UK economy, particularly for sectors that are most dependent on household spending. The impact will vary by region – largely down to sector composition, but also differences in income levels, with those on higher incomes better placed to cope with rising prices.

## The eventual rebound in 2024 will be driven by sectoral composition in high value sectors.

Inflation is expected to fall quite quickly throughout 2023, easing the pressure on living standards and laying a foundation for a recovery in 2024 and beyond. In line with historical trends, London and the South-East are expected to continue to lead the way in terms of growth. This growth will be driven by the distinctiveness of London's economy, which is characterised by knowledge-based sectors, the concentration of high-skilled workers in these sectors, and a demographic advantage in the form of a relatively young and growing labour force compared to the rest of the UK.

> There has a been a notable return to pre-COVID-19 trends in regional economic growth

## This is also evident in the performance forecast for cities, which will be the most resilient in terms of employment and growth.

A number of major cities in England are forecast to perform comparatively well compared to the UK average, with Reading, Bristol and Manchester all forecast to experience positive growth during 2023, again reflecting sector and labour market advantages.

## Opportunities for growth remain; both in traditional parts of the economy through productivity interventions, and through enabling high-growth sector delivery.

Whilst pandemic traces remain evident in the economy, the onus must now swing towards unlocking investment and stimulating innovation, with the Private Sector likely to play an expanding role in both the financing and delivery of growth. At the national level policymakers should target a suite of productivity measures for foundational sectors, blended with high-growth investible propositions for every region, these could jointly propel growth prospects. Regional policymakers, able to make targeted interventions through applying granular understanding of the skills base and labour capacity in their regions, should focus on areas of competitive advantage that can close regional disparities. In either case, setting a growth agenda underpinned by investment will set all regions on a more secure path over the coming years.

# UK and regional economic performance in 2022

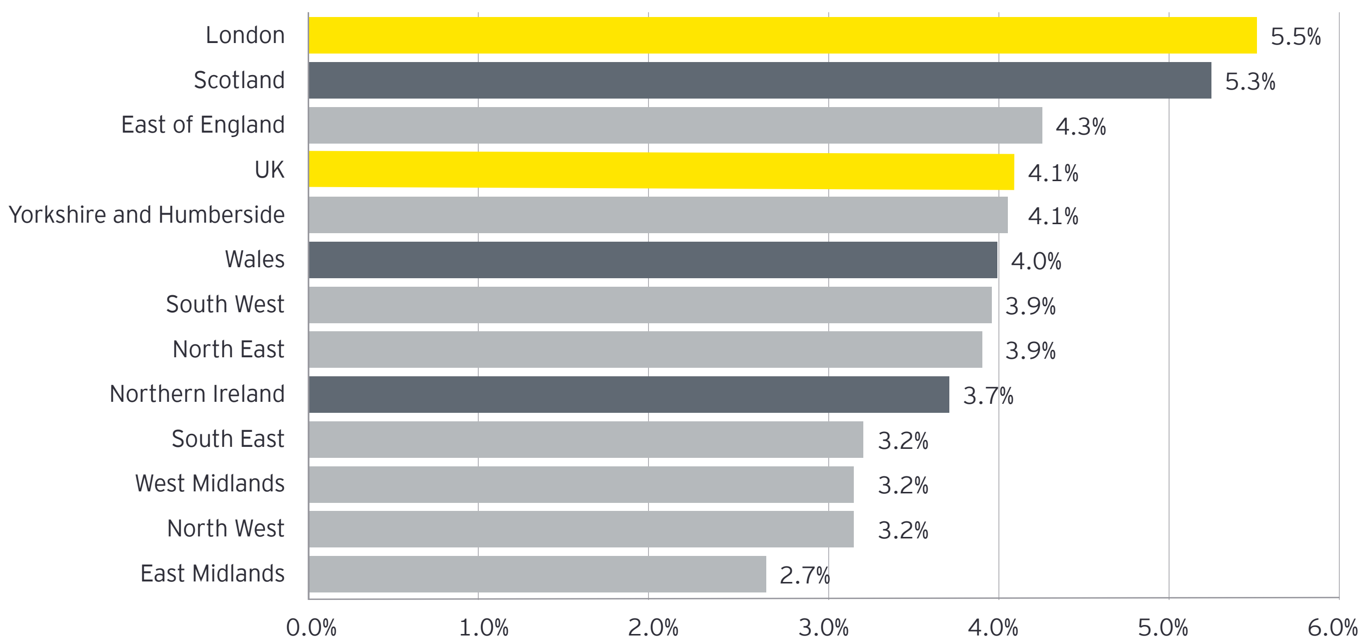

**London continued to lead the way on economic growth in 2022 ...**

During 2022, GVA is estimated to have grown by 4.1% for the UK, with GVA expected to have expanded across all the UK regions. However, there has a been a notable return to pre-COVID-19 trends in regional economic growth, with London outperforming the rest of the UK. Growth rates for all the regions still reflected an element of post-COVID-19 bounce back, as these annual rates reflect the weak starting point of the UK economy in 2021. This is particularly true for Scotland where, after underperforming in 2021, GVA growth is estimated to have been 5.3% in 2022. Behind London and Scotland, the next fastest growing region in 2022 was the East of England, supported by strong recovery in the Accommodation and Food Services and Arts, Entertainment and Recreation sectors. However, not all sectors have recovered to pre-pandemic output levels.

In particular, output in the Wholesale and Retail Trade sector remains 17% below pre-pandemic output levels across the UK, reflecting the squeeze on incomes from higher inflation, and, particularly in city centres, the now apparently permanent shift to hybrid working. For areas such as the East and West Midlands and the North West, where this sector is one of the largest, this is hindering economic growth.

During 2022, GVA is estimated to have grown by 4.1% for the UK

**Figure 1:** GVA growth in UK regions and nations 2022




Source: EY, EY ITEM Club

**... and has now had the strongest post-pandemic recovery.**

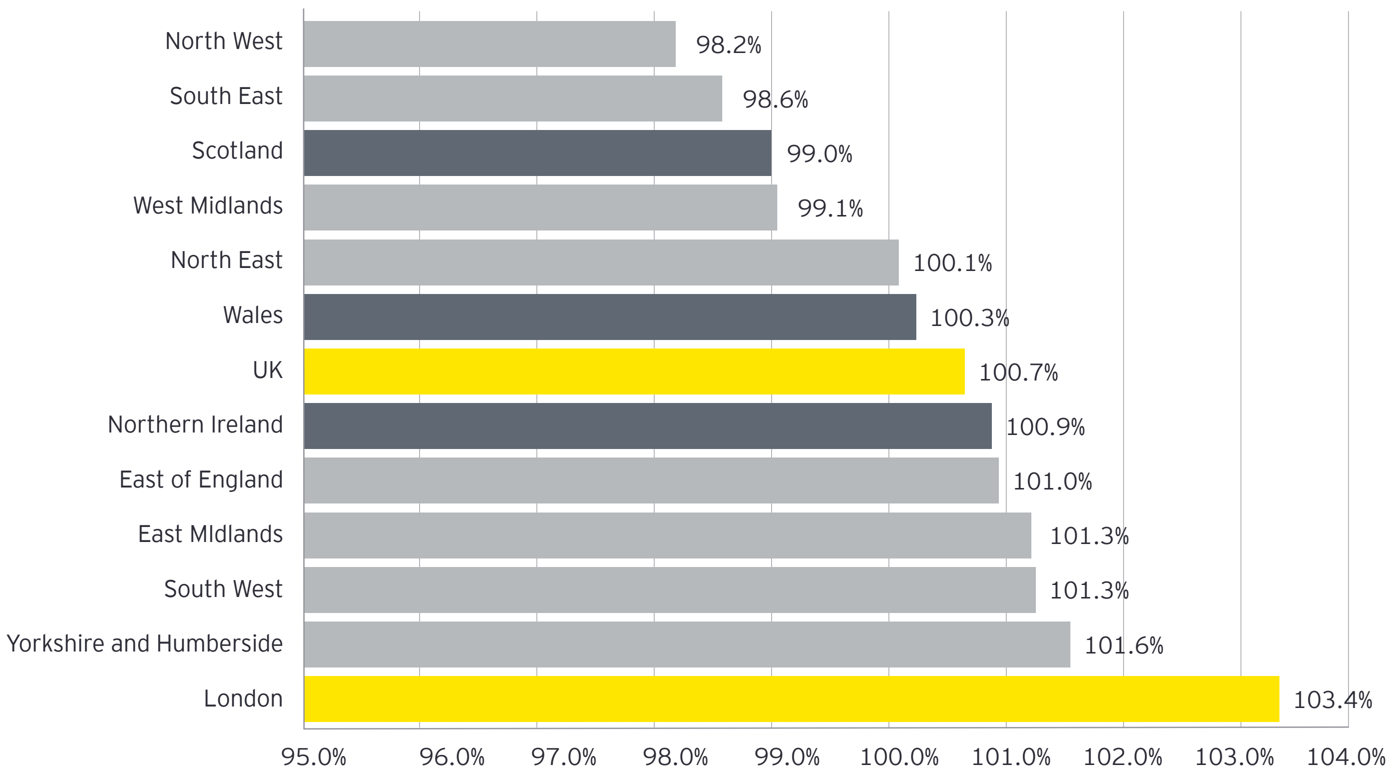
London's economic output is now 3.4% higher than its pre-COVID-19 levels in 2019 and is therefore the only region that will have achieved average annual growth of c. 2% between 2019 and 2022. At this point last year, London's economy appeared to be lagging the recovery, suggesting some "levelling down" was occurring. However, stronger growth in 2022 (alongside some material revisions to the national accounts data by the ONS reflecting "COVID-19 noise") reversed this position and it again looks like the gap between London and the rest of the economy widened.

**However, the nationwide picture of regional recovery from COVID-19 is mostly positive ...**

Positive growth in 2022 means that the majority of regions have now returned to pre-pandemic output levels, including the North East, Wales and Northern Ireland. However, there are regions where recoveries have been slower. As demonstrated below, both the North West and the South East output levels remain below 2019 levels. For the North West, this is predominately driven by the fact that neither the Manufacturing sector nor the Wholesale and Retail Trade sectors have returned to 2019 output levels.

Manufacturing output represents 14% of the North West economy and as of the end of 2022, output levels were still roughly 2% below 2019 levels. Similarly for Wholesale and Retail Trade sectors, which represent 10% of the North West economy, output remained 19% below 2019 output levels. For the South East there is a similar picture, with Manufacturing – which represents 8% of output in the region – remaining 5% below 2019 output levels in 2022. Meanwhile, Wholesale and Retail Trade – which represents 10% of output – remains 16% below 2019 output levels.

**Figure 2:** Indexed regional GVA levels – 2022 (2019=100)




Source: EY, EY ITEM Club

**Employment growth has helped drive unemployment rates close to historically low levels.**

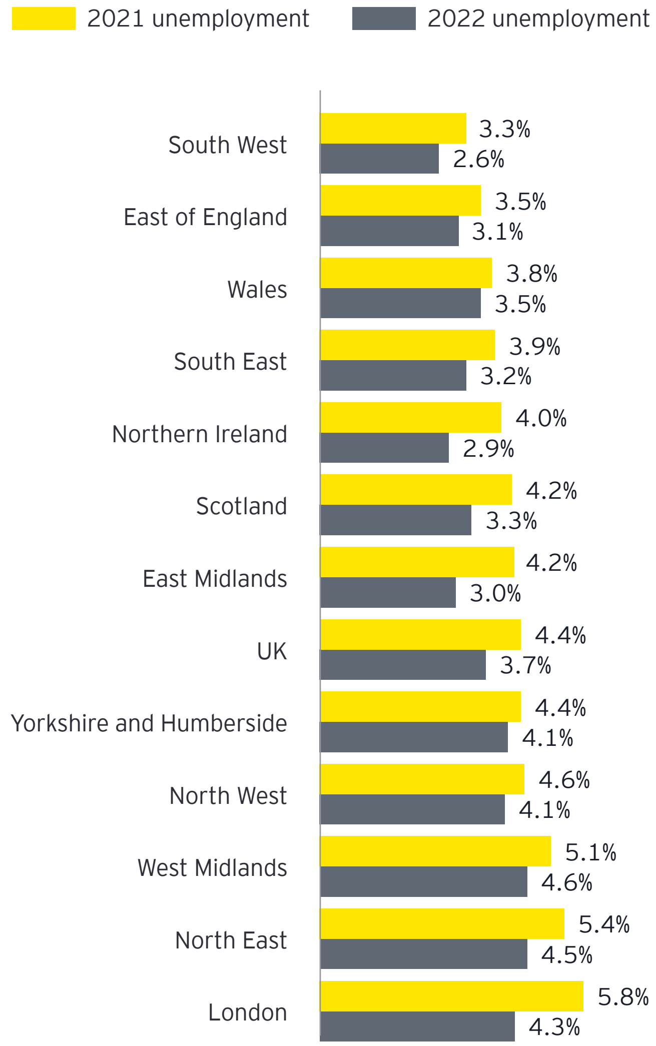
The economic recovery has led to significant declines in unemployment rates compared with 2021. The overall unemployment rate for the UK fell to 3.7% in 2022. Notably, unemployment is at its lowest levels in the South-West, where the unemployment rate is only 2.6%. The low levels of unemployment have also driven record high job vacancies, with businesses continuing to report recruitment difficulties. In the three months to August 2022, there were fewer unemployed people than job vacancies and the labour market still remains tight at the national level, with the number of vacancies per unemployed people – a key gauge of labour market tightness – running well above historical norms.

Perhaps surprisingly, unemployment rates in London remain higher than most of the UK. This is partly driven by the younger population in the capital, with unemployment rates significantly higher for 16–24-year-olds compared to other working age groups. At the same time, London has witnessed the biggest decline in the unemployment rate, with the rate dropping by 1.5 percentage points since 2021. The fall in unemployment has also been significant in the East Midlands, where unemployment has fallen by 1.2 percentage points. This outlines that strong employment growth is helping alleviate some structural challenges (e.g., higher youth unemployment) in the labour market.

The smallest reductions in unemployment rates occurred in Wales and Yorkshire and Humberside, where unemployment rates only fell by 0.3% percentage points. For Wales this came alongside high employment growth, which was 4.4% during 2022.

The economic recovery has led to significant declines in unemployment rates compared with 2021

**Figure 3:** Unemployment rate (% of economically active population)



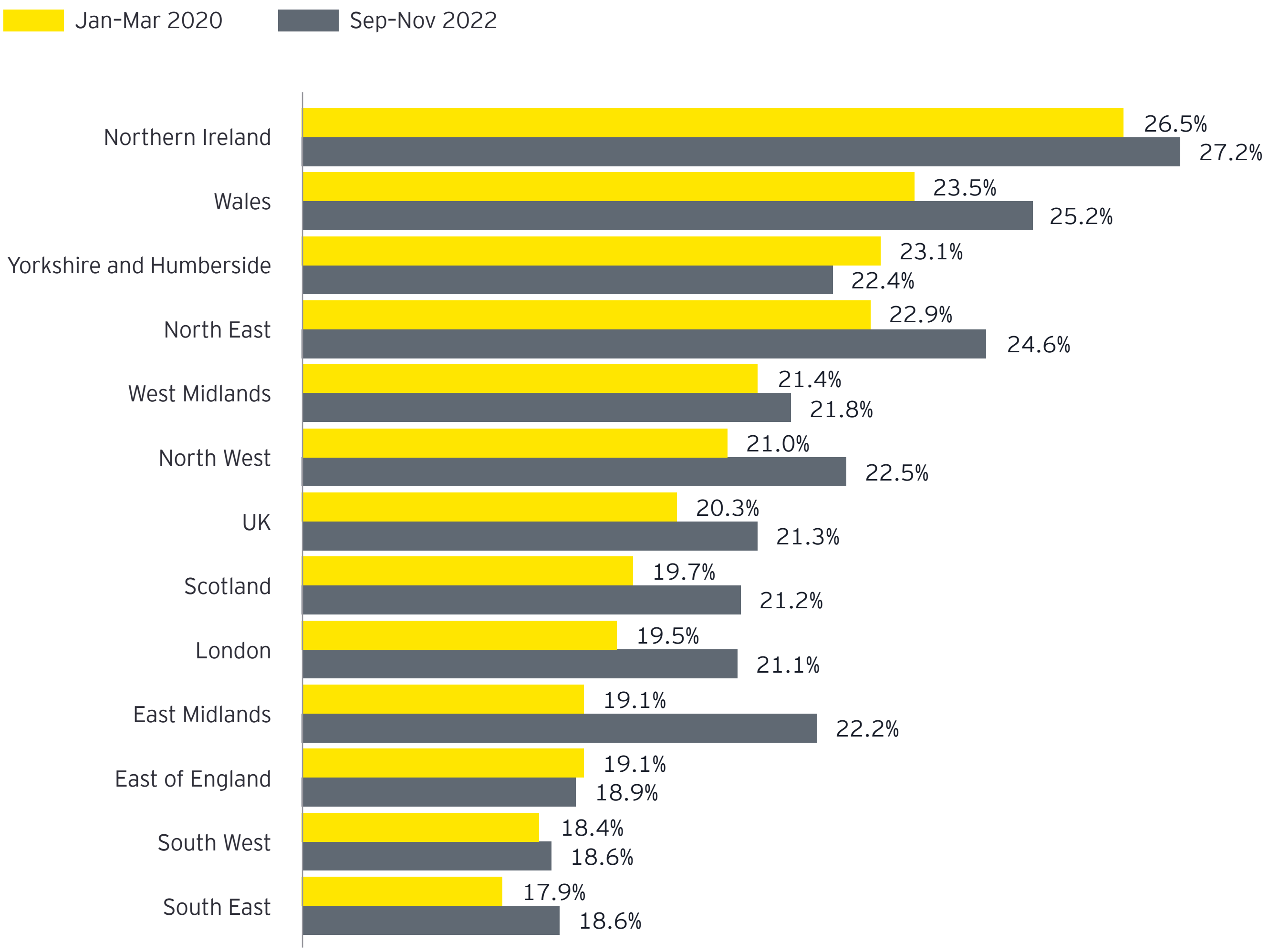

Source: EY, EY ITEM Club

**However, economic inactivity rates continue to rise across most English regions.**

The very robust labour market also partly reflects a significant rise in the number of people of working age (16–64) registered as economically inactive. Across all regions, except the East of England and Yorkshire and Humberside, the portion of the working age population that are economically inactive has risen. In the North East of England, roughly 1 in 4 people were economically inactive in September–November 2022, with rates also significantly increasing in the North West, East Midlands and London. A large proportion of those leaving the workforce are between 50 and 64 years old, with long-term illness being identified as one of the key drivers for inactivity.

The increase in inactivity represents a challenge for both businesses and policy makers, in particular addressing the issue of long term sickness. However, there has also been a significant increase in the number of students (treated as economically inactive), who should return to the labour market with improved skills levels, representing a longer term upside.

**Figure 4:** Economic inactivity rates (% of working population)




Source: ONS



# Outlook for 2023 and beyond

**The UK economy will face a recession in 2023 …**

Whilst headline growth for 2022 looks robust, there has been a significant slowdown in activity since mid-2022 as cost-of-living pressures have intensified. Forward looking indicators such as Purchasing Manager Indices (PMIs) have been flashing red since the late summer, and retail sales have declined, as higher inflation and economic uncertainty have taken a toll on business and consumer confidence. Our forecast therefore reflects that the UK economy is expected to fall into recession during 2023, with output forecast to contract by 0.6%.

However, there is a significant difference in the extent of the decline expected in London — where the economy is forecast to contract by just -0.2% — compared to the average of 0.6% for the country as a whole. The steepest contraction is forecast for the East Midlands and Yorkshire and Humberside, where output is expected to decline by 1.0% in 2023. Large forecast declines in the Manufacturing sector and Wholesale and Retail Trade sectors are driving the worsened position in these regions, with both sectors forecast to be negatively impacted by reduced consumer spending during 2023.

**… being predominately driven by forecast declines in consumer facing services.**

Driving the contraction in UK output are forecast declines in services most dependent on household spending, with Wholesale and Retail Trade (-3.3%), Manufacturing (-2.9%), and Accommodation and Food Services (-2.7%) the most adversely impacted sectors. With inflation reaching close to 40-year highs in October 2022 (11.1%), consumers' ability to spend has been weakened across all regions. In comparison, industries in the public sector which are less reliant on paid consumer services such as Human Health and Social Work (1.3%), Education (1.2%) and Public Administration and Defence (0.9%) are all forecast to grow marginally during 2023 and regions where these sectors are more prominent may therefore be insulated against recessionary impacts.

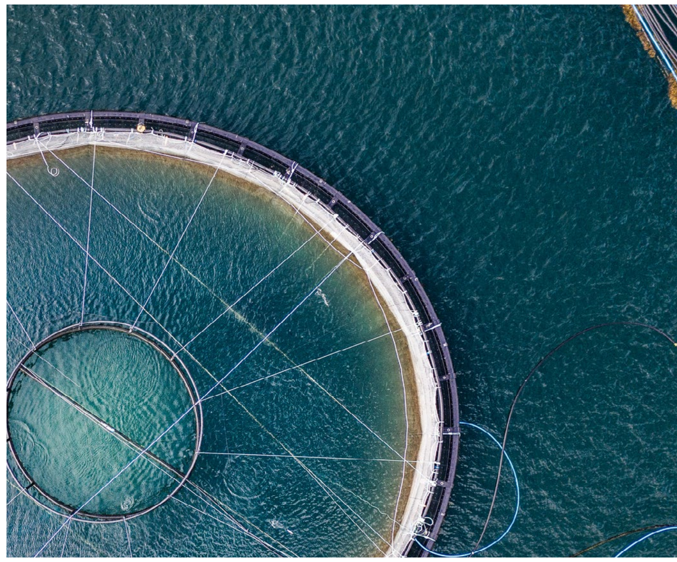
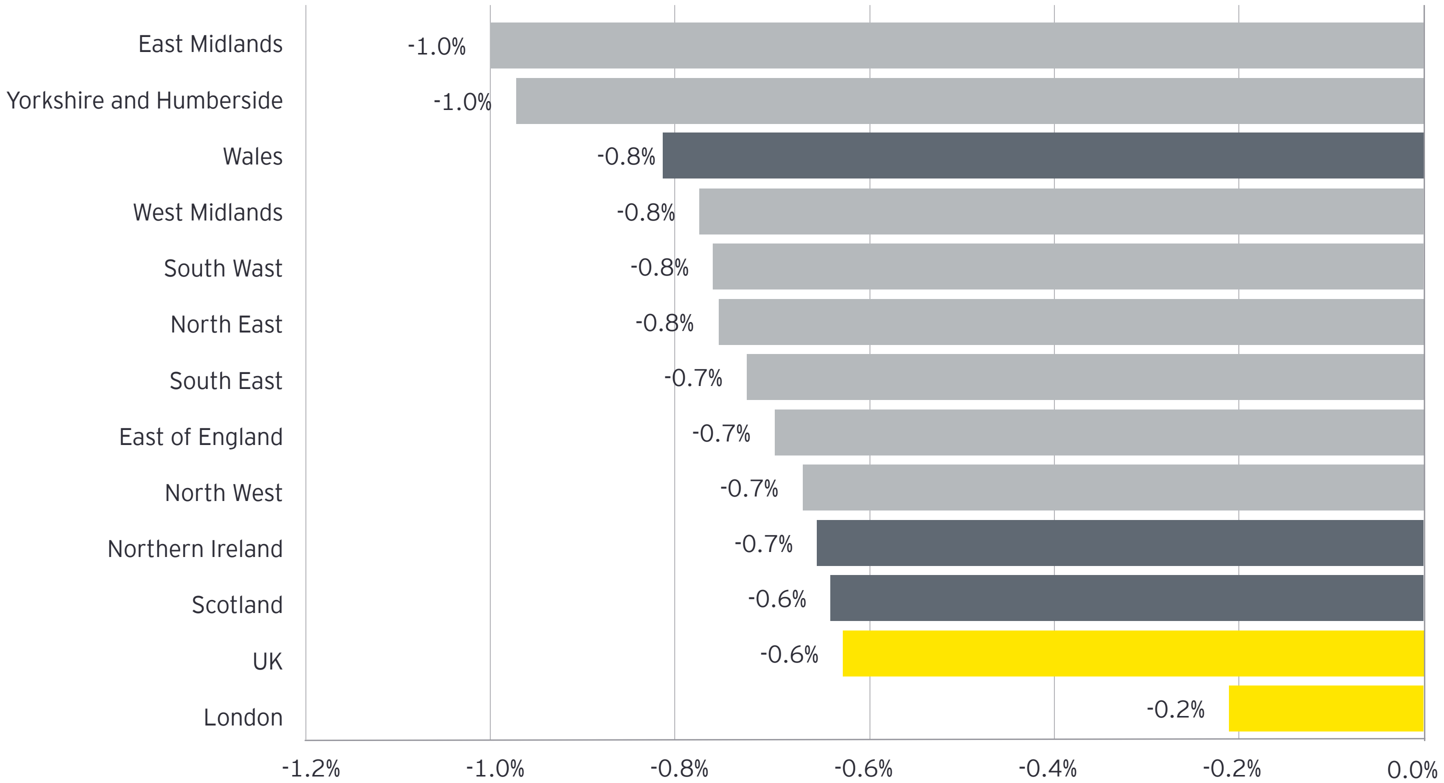
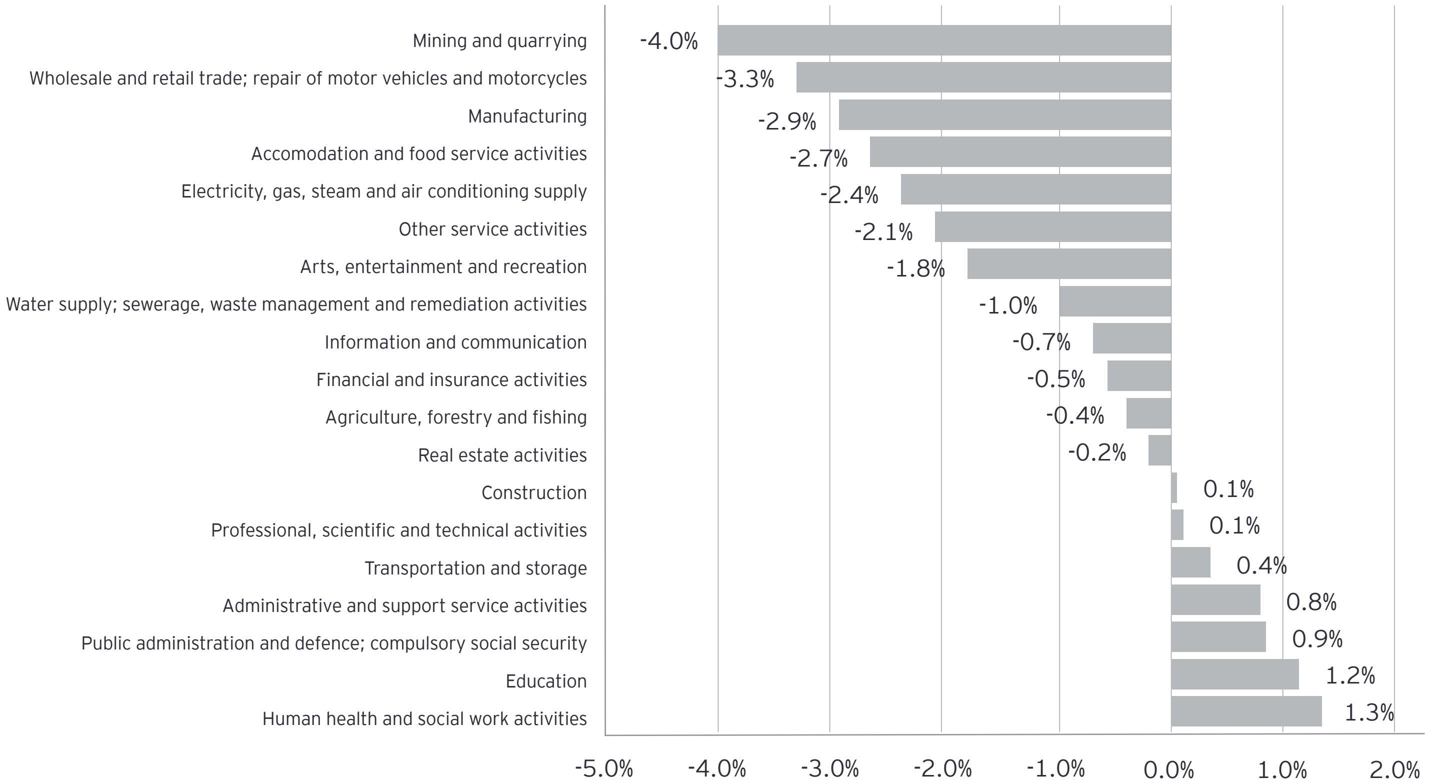


**Figure 5:** GVA growth in UK Regions 2023




Source: EY, EY ITEM Club

**Figure 6:** UK GVA growth in by sector 2023




Source: EY, EY ITEM Club

### A return to growth in 2024 …

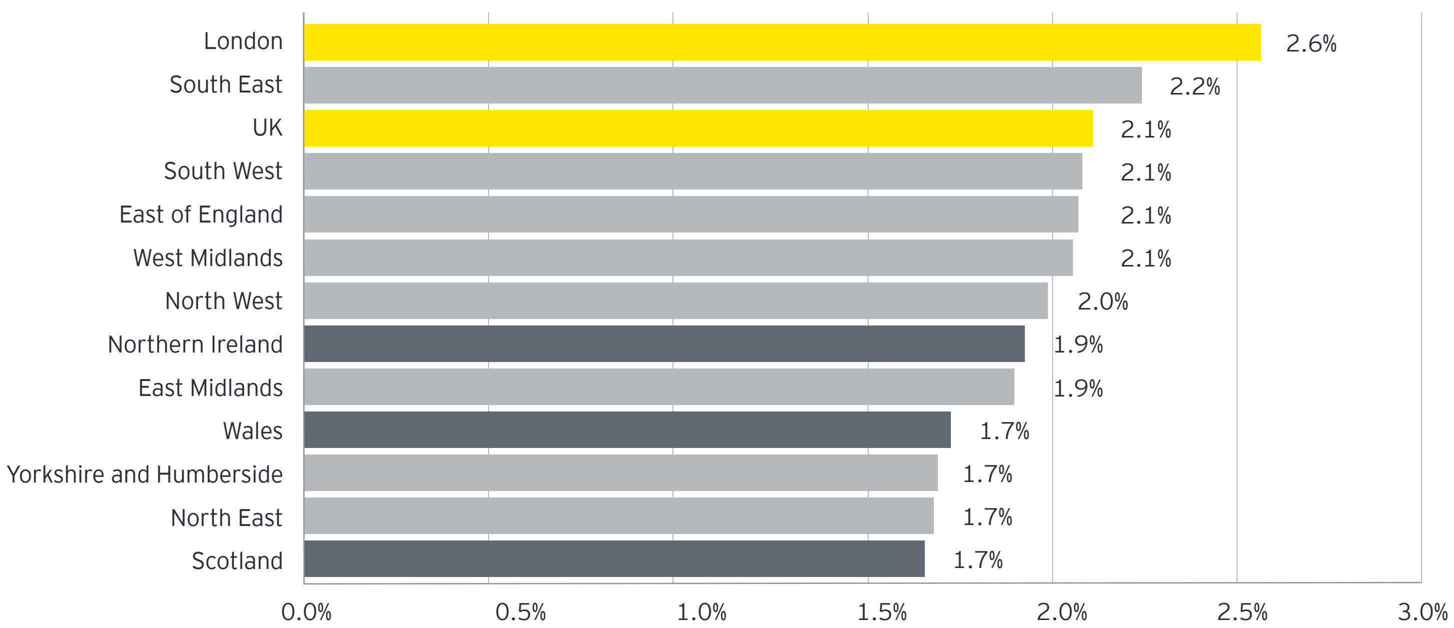
Inflation is expected to fall quite quickly throughout 2023, easing the pressure on living standards and laying a foundation for a recovery in 2024 and beyond. In line with historical trends, London and the South East are expected to continue to lead the way in GVA growth, with output forecast to grow at an annual rate of 2.6% between 2024 and 2026 for London. This growth will be driven by the distinctiveness of London's economy, which is characterised by knowledge-based sectors such as professional services, information and communication, and the concentration of high-skilled workers in these sectors. These same factors are also forecast to result in relatively high growth rates in the South East of England, where the average annual growth forecast trails just behind London at 2.2% in the medium-term. The West Midlands and the South-West are also forecast to grow more quickly than the UK average, with strong growth in Information and Communication sector, helping the outlook compared to the UK average.

### … driven by differences in sector composition and outlook.

The differences in economic performance in the medium-term are predominantly driven by sector composition in regions. Information and Communication services are forecast to be the highest growing sector in the medium-term, meaning regions where this sector is largest are forecast to have higher growth rates. As outlined below, for London and the South East, a higher share of the regional economy is made up of high-growth sectors compared to the national UK average, helping explain why they are expected to be the two highest growing regions over the medium-term. Whereas for the North East, Yorkshire and Humberside and East Midlands current sector composition is more heavily concentrated in sectors which are forecast to be low growth sectors in the medium-term, in particular Manufacturing, helping explain why headline growth figures for these regions lag behind the UK average.

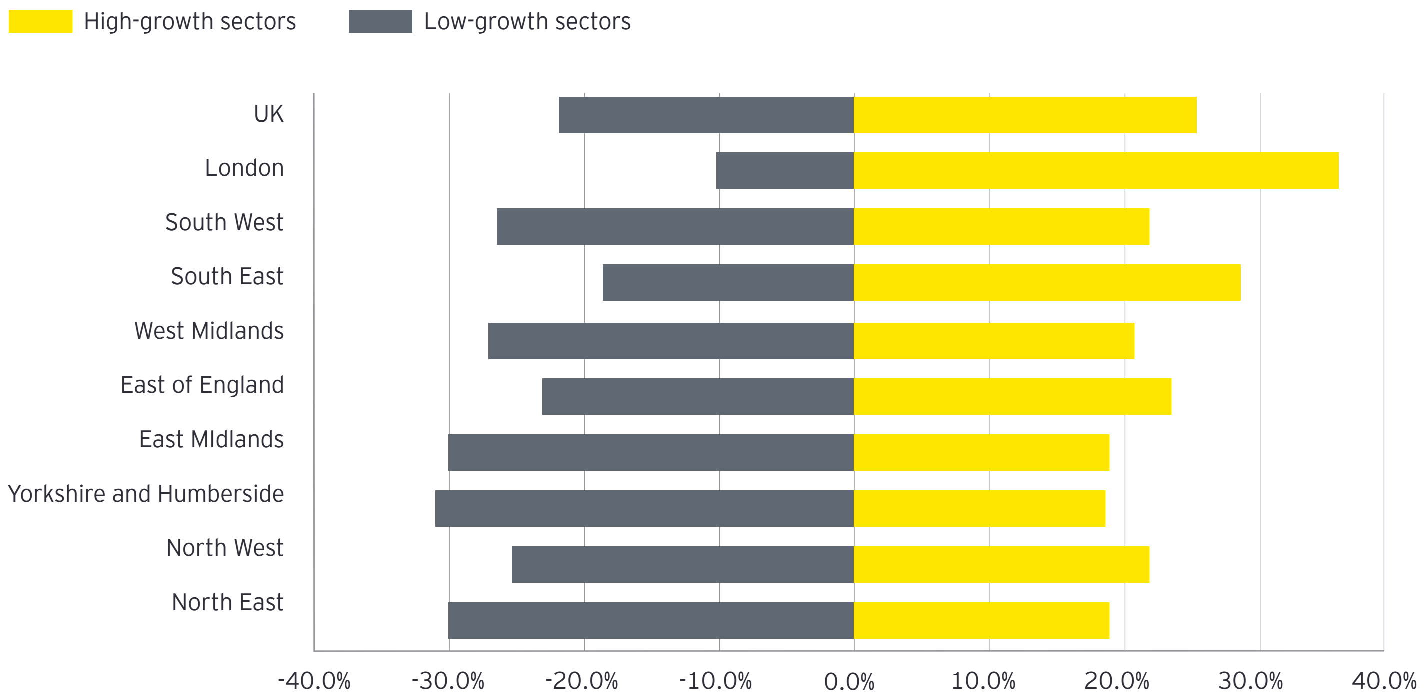
## London and the South East are expected to continue to lead the way in GVA growth

**Figure 7:** UK annualised GVA growth by region 2024–2026




Source: EY, EY ITEM Club

**Figure 8:** Exposure to five highest performing sectors and five lowest by UK region – percentage share of sector GVA 2022



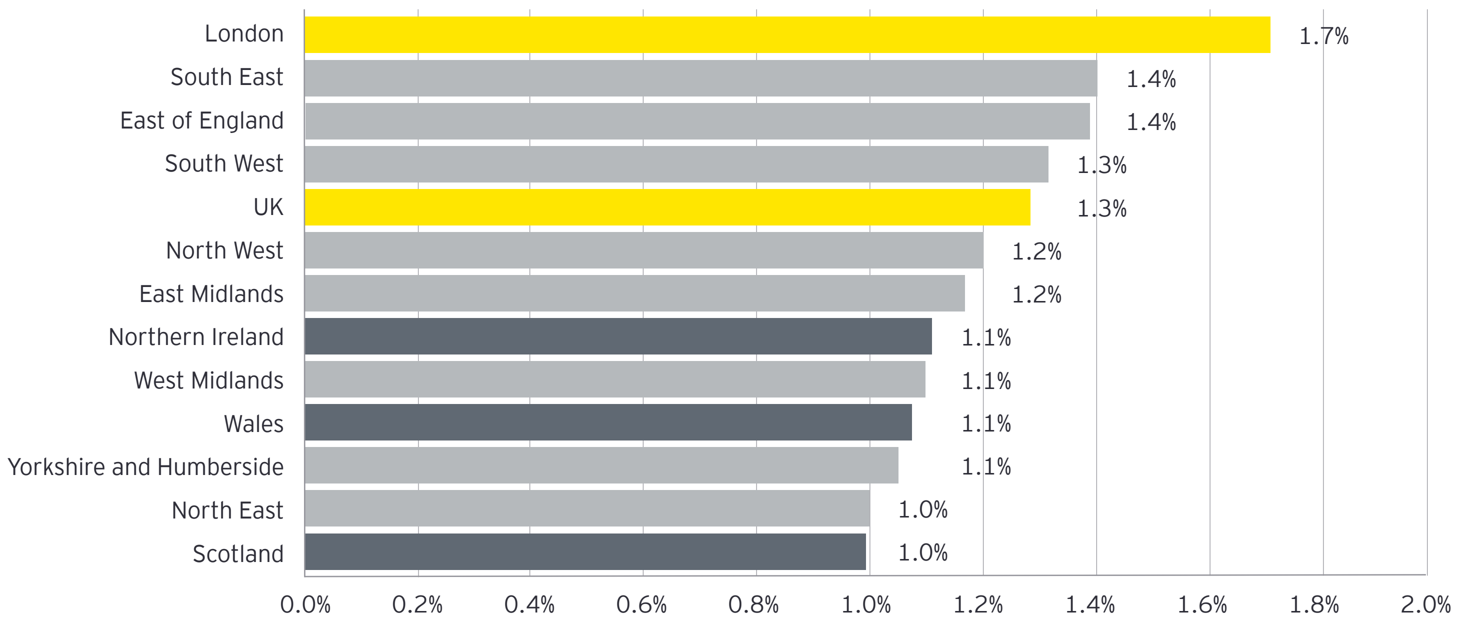

Source: EY, EY ITEM Club

## Employment growth between 2024 and 2026 is forecast to be highest in London, at an annual average of 1.7%

**Concurrently, the differences in growth rates extend to the labour market.**

Employment growth between 2024 and 2026 is forecast to be highest in London, at an annual average of 1.7%. For London, the sectors with the highest employment growth are; Arts, Entertainment and Recreation services and Professional, Scientific and Technical activities, where employment is forecast to grow on average by 2.8% and 2.3% per annum respectively. Employment growth is forecast to be weakest in Scotland and the North East, at just 1.0%, and both areas. Reductions in employment for Manufacturing are weighing on headline figures.

**Figure 9:** UK annualised employment growth by region 2024-2026




Source: EY, EY ITEM Club



# Performance across the UK at a city and town level

**Growth rates in the majority of UK cities outpaced average growth for the UK …**

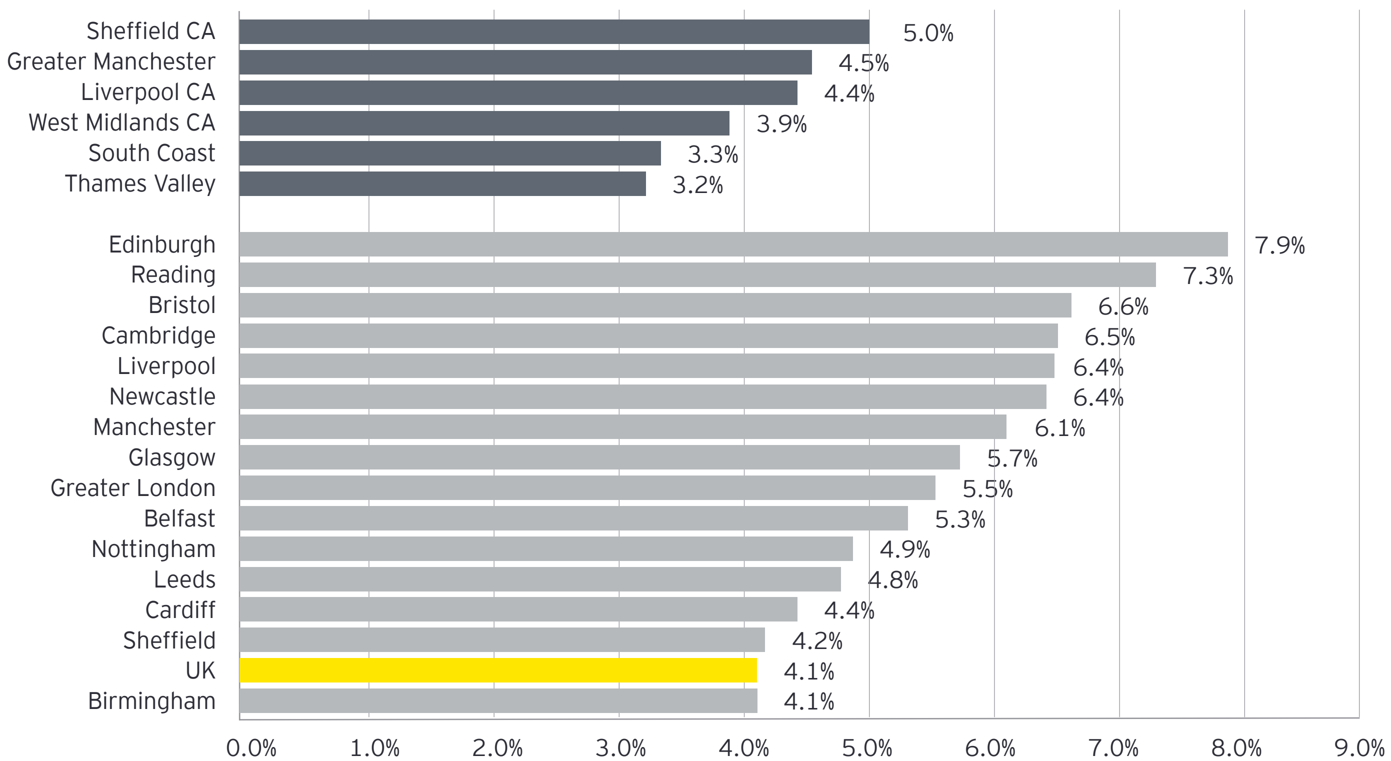
Higher rates of growth in UK cities reflect bounce-backs in consumer-facing industries following the impacts of restrictive lockdowns and work-from-home guidance during 2020 and 2021. GVA growth is forecast to be highest in Edinburgh, Reading, Bristol, and Cambridge, where strong recovery in Accommodation and Food Services, Arts, Entertainment and Recreation and Administrative and Support service sectors, have driven differential growth rates in these cities.

**… however much of this is recovery growth and output remain below pre-pandemic levels in many major cities.**

For several city areas, output levels are below pre-pandemic levels, indicating that high growth forecast for 2022 reflects recovery growth. Manchester's economic output is forecast to be 97.8% of its pre-pandemic levels by the end of 2022. Interestingly, economic output for Greater Manchester is slightly closer to pre-pandemic levels, with output 99.1% of 2019 levels. This indicates that areas outside the city centre in Greater Manchester have recovered quicker. The reverse is true for Liverpool, where economic output levels are now 0.4% higher than pre-pandemic levels whereas output for the combined authority area of Liverpool is 2.0% lower than pre-pandemic levels. This indicates that for Liverpool, output has recovered more quickly in the city centre than the surrounding areas.

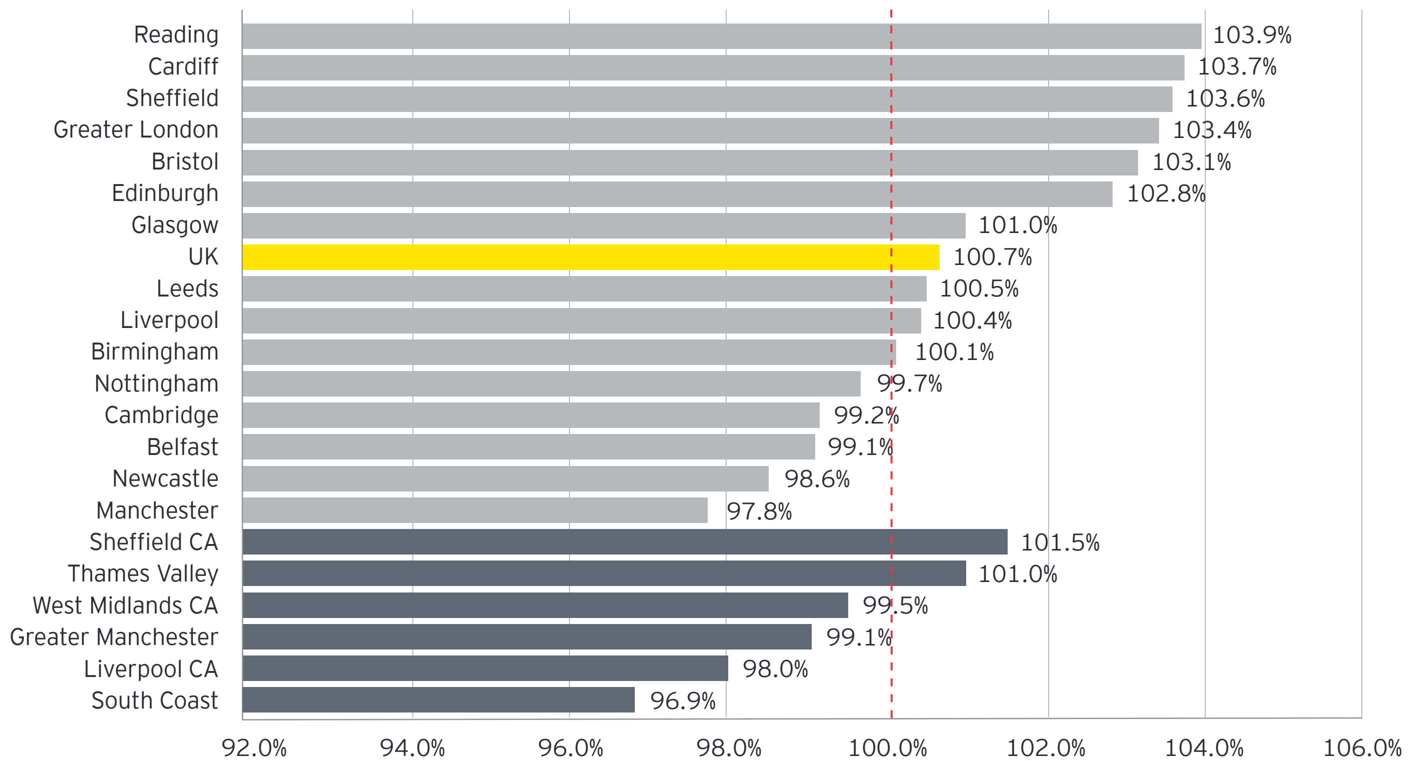
## GVA growth is forecast to be highest in Edinburgh, Reading, Bristol, and Cambridge

**Figure 10:** GVA growth in major cities and combined authorities – 2022




Source: EY, EY ITEM Club

**Figure 11:** Indexed GVA output – major cities – 2022 (2019=100)




Source: EY, EY ITEM Club

## There are a number of major cities in England which appear to perform comparatively well compared to the UK average

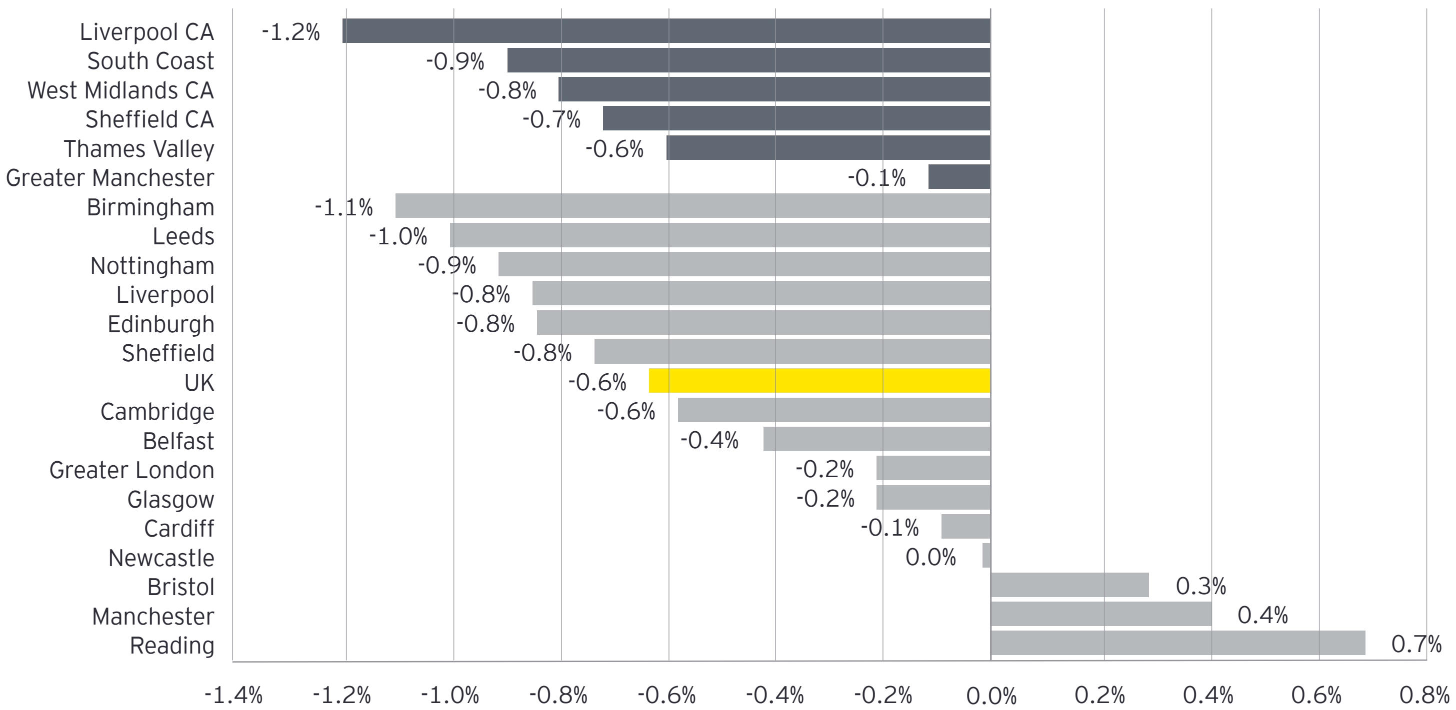
**Major cities also appear to be better insulated against the recession forecast for 2023 ...**

The global disruption and economic uncertainty described in the previous section are forecast to impact towns and cities during 2023, with GVA forecast to decline in the majority of towns and cities. However, as demonstrated below, there are a number of major cities in England which appear to perform comparatively well compared to the UK average, with Reading, Bristol and Manchester each forecast to grow during 2023. For Reading, this is driven by high growth in the Professional, Scientific and Technical Activities sector which is forecast to grow by 2.7% during 2023. Similarly for Bristol growth of 1.6% in the Professional, Scientific and Technical Activities, helps support positive growth alongside high growth in the Administrative and Support sectors of 2.5%. For Manchester high growth in the Human Health and Social Work sector (1.7%) and Accommodation and Food Services (2.5%), helps maintain small growth in the region – suggesting that it may still be benefiting from some COVID-19 catch up relative to other cities.

**... significant declines in employment are not forecast for most major cities.**

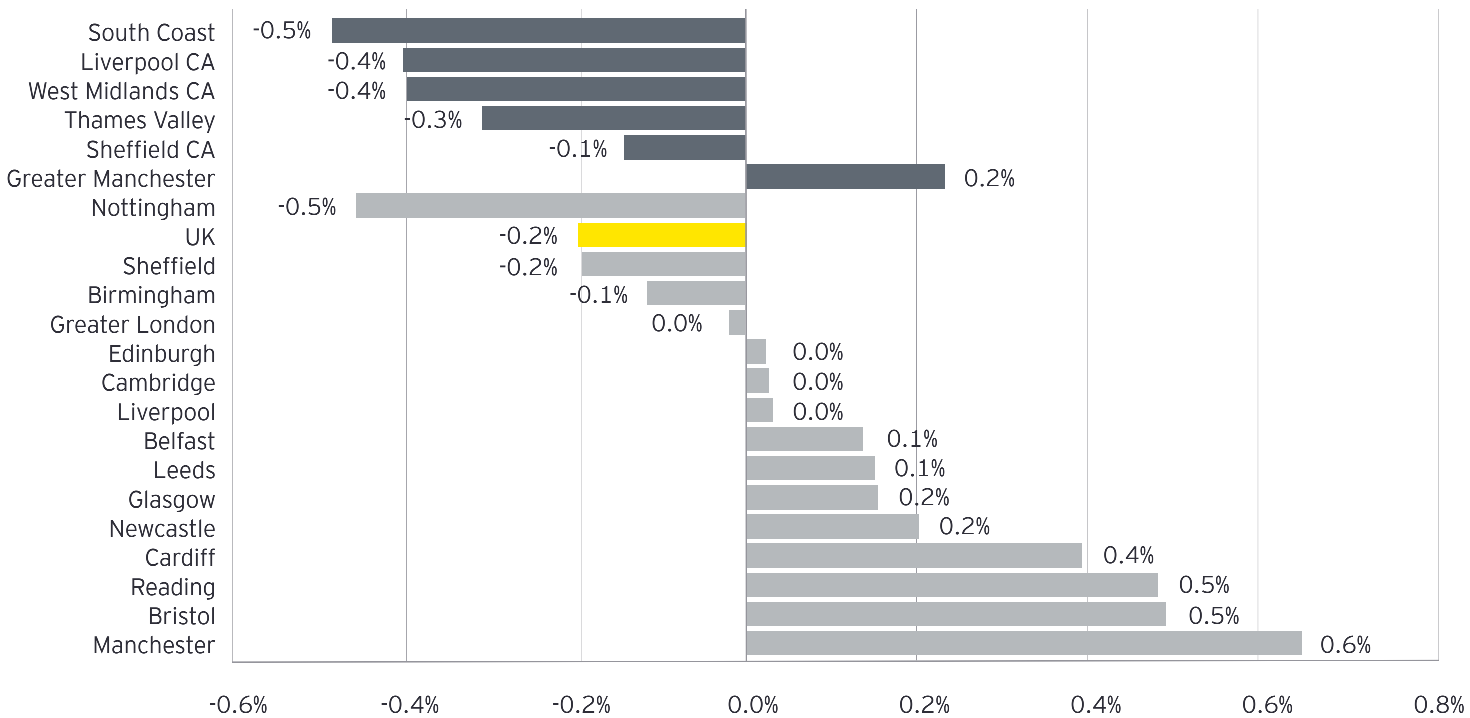
The effects of the forecast recession are not expected to have significant impacts on the UK labour market, with employment only forecast to decline by 0.2% during 2023. As demonstrated below, in many major cities, employment is forecast to increase during 2023 with the highest growth forecast for Manchester and Bristol, where growth is forecast to be 0.6% and 0.5% respectively.


**Figure 12:** GVA growth in major cities – 2023

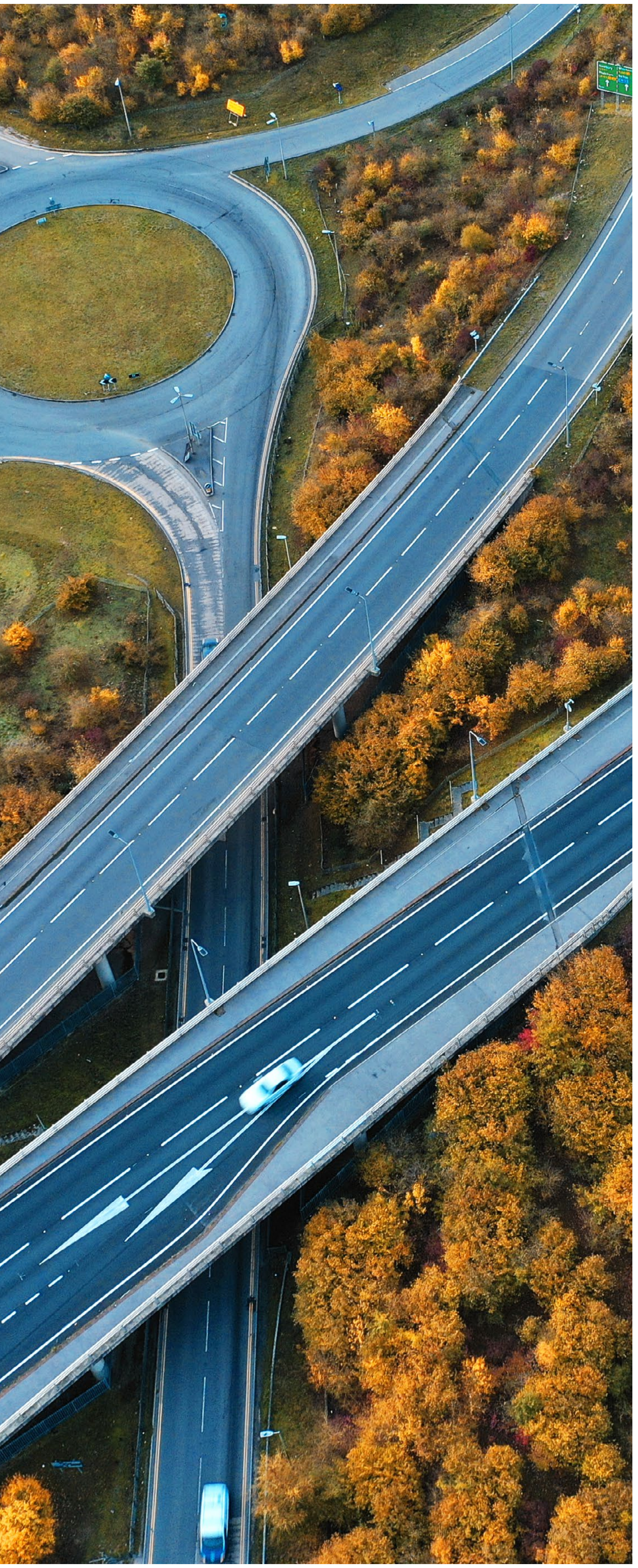



Source: EY, EY ITEM Club

**Figure 13:** Employment growth in major cities – 2023




Source: EY, EY ITEM Club



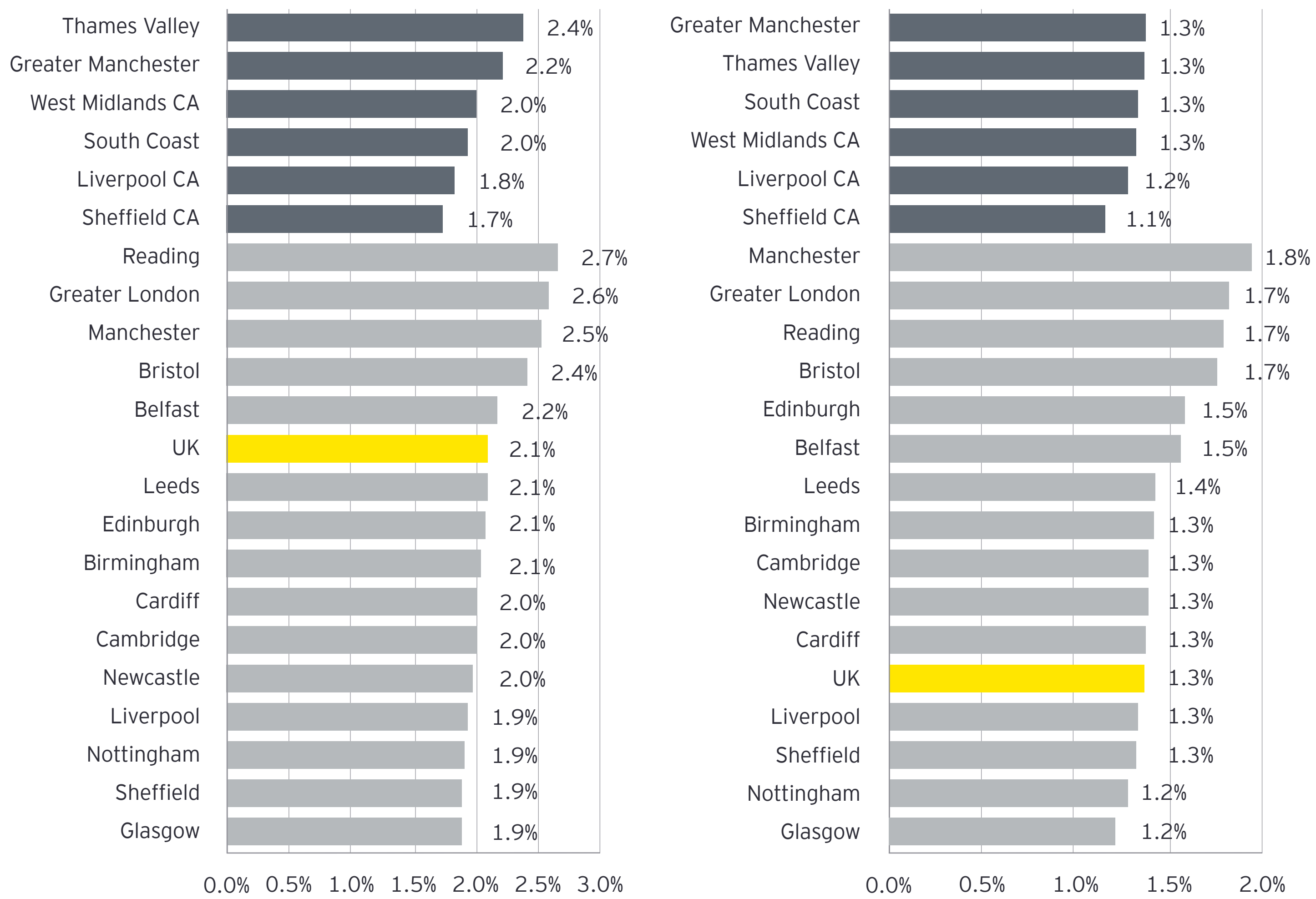
**This trend is less evident for the medium-term growth prospects of major cities ...**

In the medium-term, fewer of the major cities significantly outpace the average growth rate for the UK and the differentials in growth rates are comparatively small compared with 2022. London, Bristol and Manchester once again stand out compared to most of the major cities, with GVA forecast to grow by 2.4-2.6% in these regions. In these areas, strong growth in Professional, Scientific and Technology Services and Administrative and Support Services appear to help drive both employment and GVA growth, with strong performance in Real Estate services also driving growth in Bristol.

**... and sector specialisms remain the main driver of differential growth over the medium-term.**

In the medium-term, Reading, London, and Manchester are forecast to be the highest growing areas. For Reading, growth is forecast to be high growth in the Information and Communication sector and Professional Services, Science and Technology growth are also driving high growth in the region, with these sectors forecast to grow by 4.3% and 3.1% per annum respectively. For Manchester, the story is similar, with the Information and Communication and Professional Services, Science and Technology sectors forecast to grow by 3.6% and 3.3% per annum respectively. Also contributing to the high forecast growth in this region is Administrative and Support Services, which are forecast to grow by 3.6% per annum over the period.

**Figure 14 and 15:** GVA and employment growth in major cities – 2024 to 2026 average growth




Source: EY, EY ITEM Club

# What are the key drivers affecting regions, cities, and towns?

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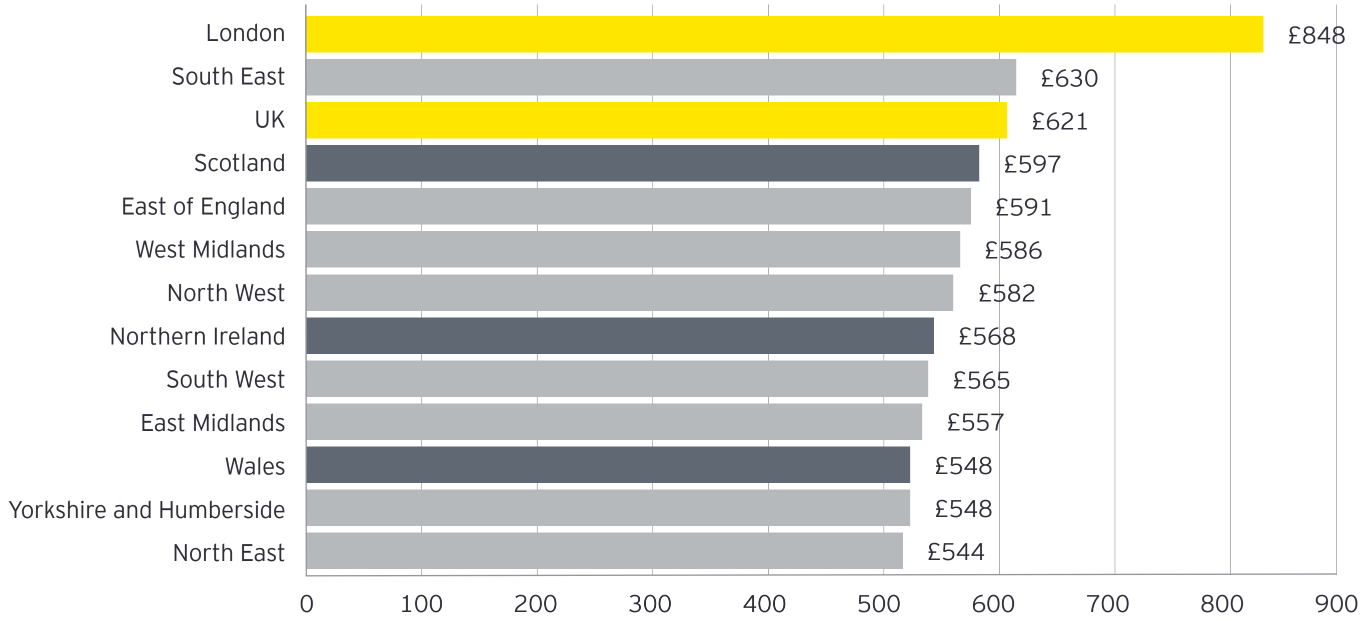
## Inflation and the cost of living continues to drive regional inequality …

One of the key drivers of the forecast decline in output and employment for 2023 is the impact of inflation and higher interest rates, which are currently squeezing household incomes, likely to reduce consumer spending, and resulting in forecast declines in output. The origins of high inflation in the UK economy pre-date the Russia-Ukraine conflict, with UK prices rising quickly at the start of 2022 as supply-chain bottlenecks and pent-up consumer demand resulted in inflationary pressure. The Russia-Ukraine conflict exacerbated these issues, resulting in the ensuing cost-of-living squeeze that has emerged within the economy, characterised by CPI reaching a 40-year high in October 2022 at 11.1%. Inflation is expected to decline quickly through 2023, but incomes will remain under pressure.

## … with the ability to absorb price increases varying by region.

The ability of households to cope with sustained rising prices will be influenced by their income, with higher levels of income providing households with greater headroom to maintain consumption levels through absorbing price increases. As income levels vary considerably by region, it is likely that the squeeze on living costs will lead to regional variations in the ability of households to cope with the high inflation environment. As demonstrated below, average weekly earnings are far higher in London compared with other regions. Average weekly earnings are £848 in London compared to £621 for the UK average, indicating those in the capital have a greater ability to absorb rises in prices without significant impacts on consumption levels. Higher income households were also the most likely to have built up "excess" savings through the pandemic. Absolute income levels are not the perfect indicator as, for example, housing costs are also higher in London, but they do provide a guide as to where the pain of higher inflation will be felt hardest.

**Figure 16:** Mean weekly income levels – 2022 – by region




Source: EY, EY ITEM Club

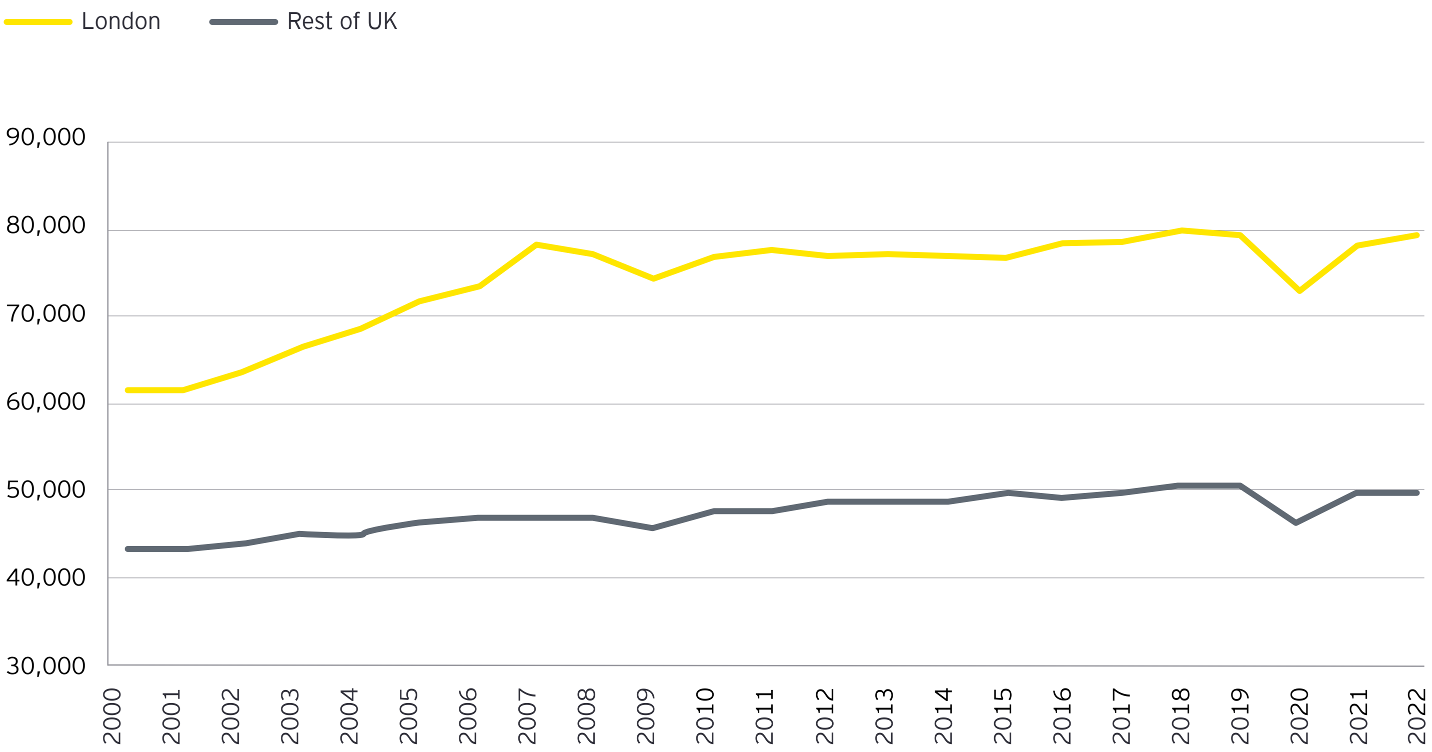
# The cost-of-living squeeze could widen current regional disparities in economic performance

The result of varying average income levels by region mean the effects of the cost-of-living squeeze are not being experienced evenly across England as the ability to protect against inflationary effects is dependent on income levels, regional variations in the levels of inflation and regional variations in disposable income. The cost-of-living squeeze could therefore widen current regional disparities in economic performance, with the richest areas of the country most able to protect themselves against inflationary effects.

**Variations in the regional outlook are also being driven by significant productivity differences between regions.**

As demonstrated below, GVA per employee in London is significantly above the average for the rest of the UK and this gap has widened over the last 20 years. This helps drive higher growth in the capital, with smaller increases in employment generally having a greater impact on total output in the economy and therefore helping drive higher growth rates. This London productivity effect looks set to continue.

**Figure 17:** GVA per employee – 2000 to 2022 (2019 prices)

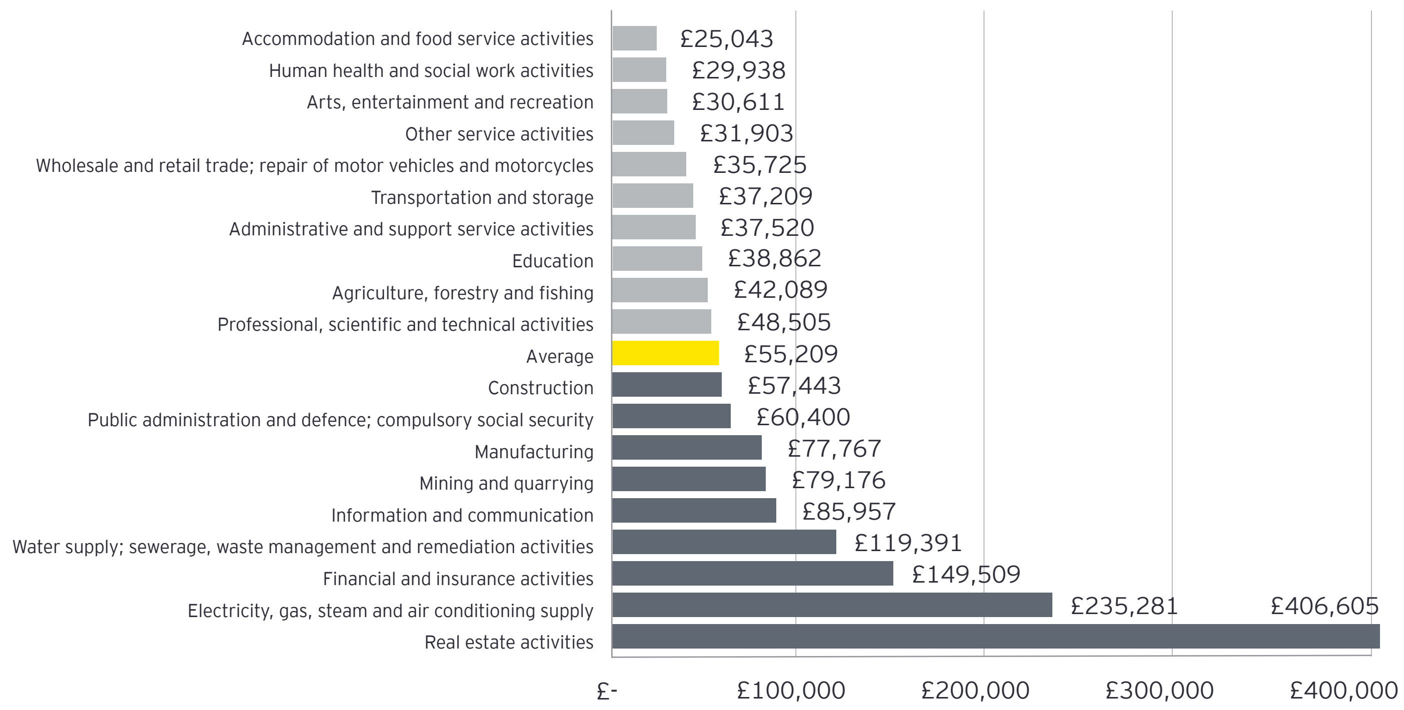



Source: EY, EY ITEM Club

**Part of these productivity gaps can be explained by the sectoral composition of regions, as across the UK there are significant productivity gaps between sectors.**

The GVA impact of employment per sector varies significantly across the industrial base of the UK economy. As outlined below, the GVA per employee for Real Estate activities is significantly larger than other sectors at £407k per employee. This is likely to reflect large profits made in commercial real estate, rather than high productivity in the sector.[1] Aside from utility sectors, Financial and Insurance Activities and Information and Communication services, stand out as sectors with high GVA per employee, with values of £149k per employee and £86k per employee respectively. This helps explain higher growth rates in London and the South East, as high concentrations of employment in these sectors helps drive growth in value adding output. Whereas for recreation and leisure sectors such as Accommodation and Food service activities and Arts, Entertainment and Recreation, GVA per employee is significantly lower at £25k per employee and £30k per employee respectively.

**Figure 18:** GVA per employee by sector – 2022 – UK




Source: EY, EY ITEM Club

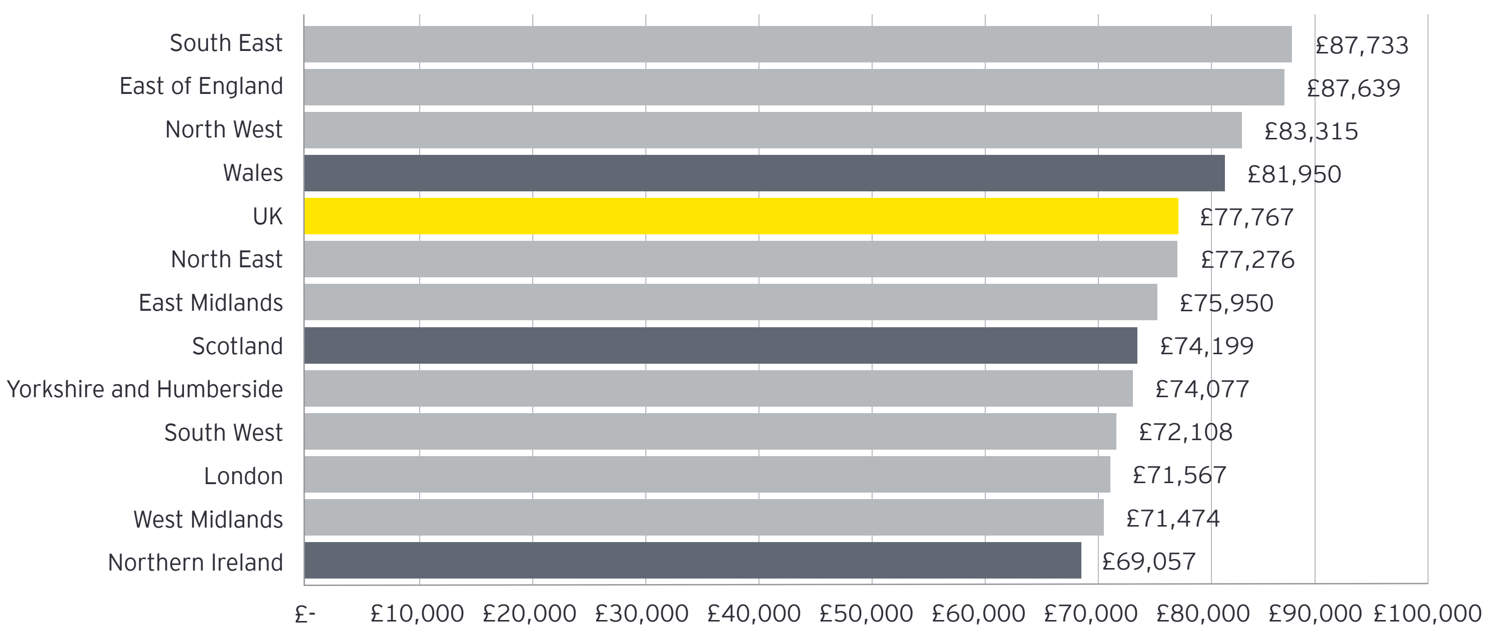
1 GVA in the Real Estate sector is largely a reflection of imputed rents rather than productive economic activity so care should be taken when interpreting the level of output per worker in the sector and comparison with other sectors. ONS estimates for 2020 show that owner-occupiers' imputed rents accounted for 71% of GVA in the Real Estate sector in the year.

However, there are perhaps other approaches to driving regional productivity. The analysis also demonstrates that pursuit of high-value jobs in areas such as Manufacturing, or construction can also be highly valuable to a locality in terms of GVA. GVA per employee in the Manufacturing sector is £77,767 across the UK, which again is higher than the average GVA per employee in the UK. In manufacturing there are also regional variations in productivity. This demonstrates that there is opportunity with sectors such as Manufacturing to pivot businesses towards more productive sub-sectors, to try and help drive regional growth.

## GVA per employee in the Manufacturing sector is £77,767 across the UK

Indeed, it is likely that a plurality of sectoral employment has a cross-cutting effect, making each sector individually more productive. This has implications for policy makers, as focussing on traditional regional strengths particularly in the face of long-term trends, such as the transition to net zero or taking advantage of the global push for more resilient, less extended, supply chains, may be a better strategy than simply trying to replicate what works in London or the South East. The drive to net zero in particular, represents an opportunity to rebuild some manufacturing capability in the UK in areas of comparative advantage (e.g., hydrogen, carbon capture and storage, new nuclear), while the related trends in construction (e.g., retrofit) could also drive opportunities to deliver higher value add jobs in the regions.

**Figure 19:** GVA per employee by manufacturing – 2022 – by region

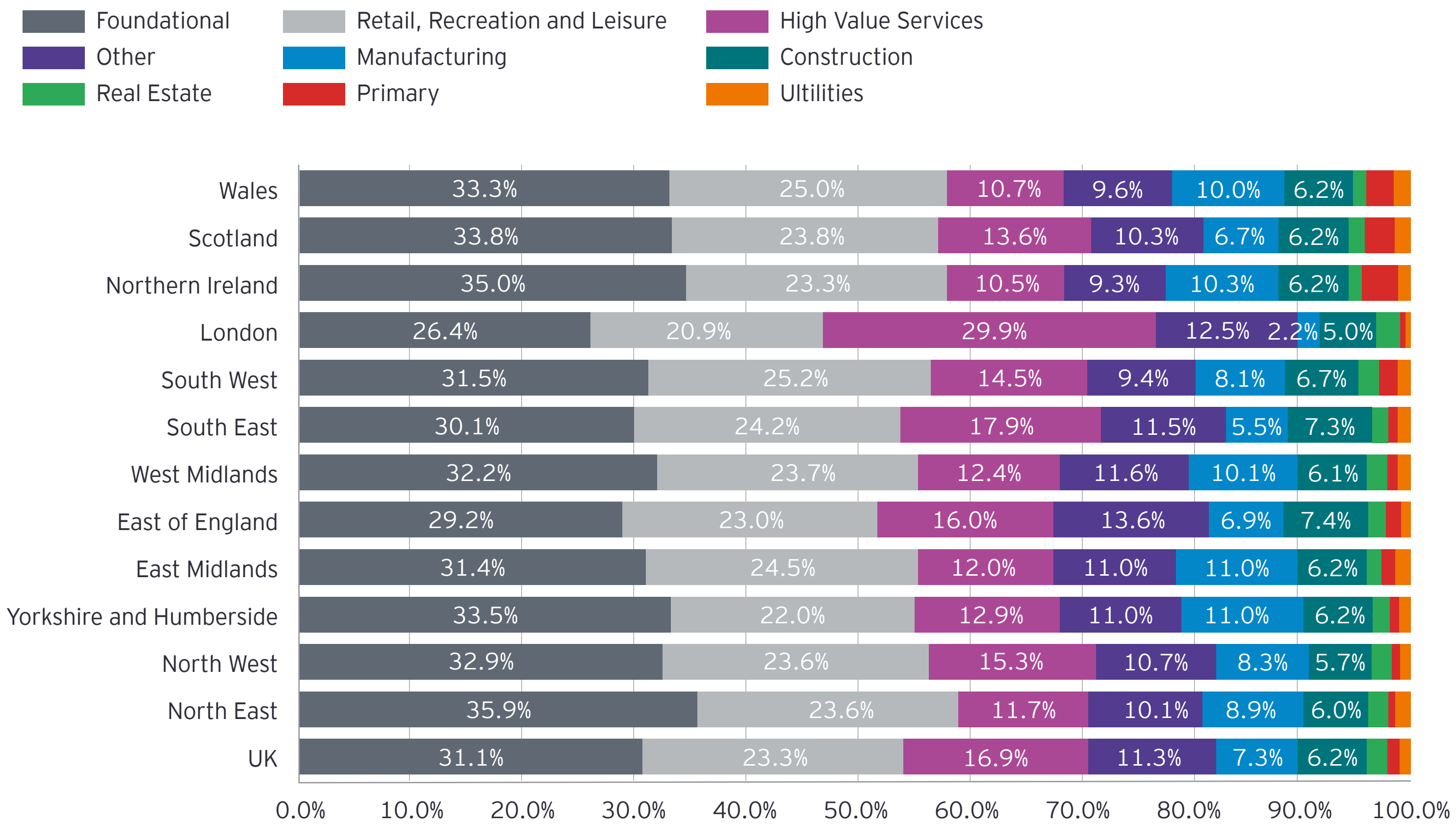



Source: EY, EY ITEM Club

**Focussing on sectoral composition is important in helping drive regional growth. Currently, London has a higher concentration of employment in high value service sectors, which is helping drive higher growth in a positive direction.**

As demonstrated below, employment concentration in what we have defined as *High Value Services*[2] is 29.9% in London compared to a UK average of 16.9%. This helps indicate one of the drivers of differential growth rates in London, as they have a higher portion of employees working in jobs where the GVA contribution is higher. Furthermore, employment in what we have defined as *Foundational*[3], is less concentrated in London than the UK average, with employment making up 26.4% of employment in London compared to a UK average of 31.1%.

**Figure 20:** % Employment by aggregate sector – 2022*




Source: EY, EY ITEM Club

2 We have defined 'High Value Services' as consisting of the following: Information and Communication; Financial and Insurance Activities; and Professional, Scientific and Technical Activities.
3 We have defined 'Foundational' as consisting of the following: Transportation and storage; Public Administration and Defence; Compulsory Social Security; Education; and Human Health and Social Work Activities.
*Sector classifications are provided in Appendix 1.

**In high value sectors, GVA per employee is also significantly higher in London than the rest of the UK ...**

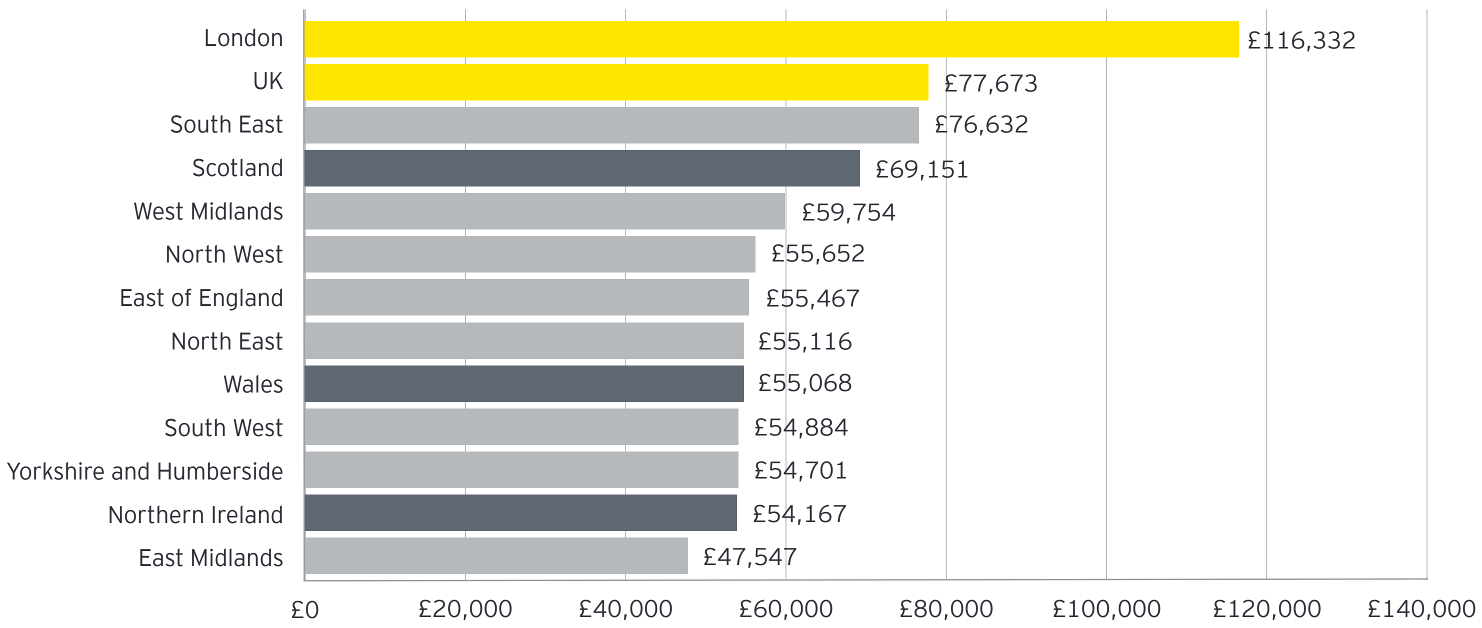
For our definition of *High Value Services*, GVA per employee in London (£116k) is far higher than the UK average (£77k). This indicates that not only does London have a higher proportion of employment in these sectors, it is also more productive in these sectors.

Whilst there is a Capital effect here, reflecting London's status within the UK, and its role as a global financial centre, there may be some opportunities for other regions to learn from London, and "level up" productivity. The regions of the UK are unlikely to match London levels of productivity, but raising the bar to levels observed in other regions outside of London (e.g., South East or Scotland) should be a reasonable aspiration.

**This productivity gap also appears to extend to the foundational economy.**

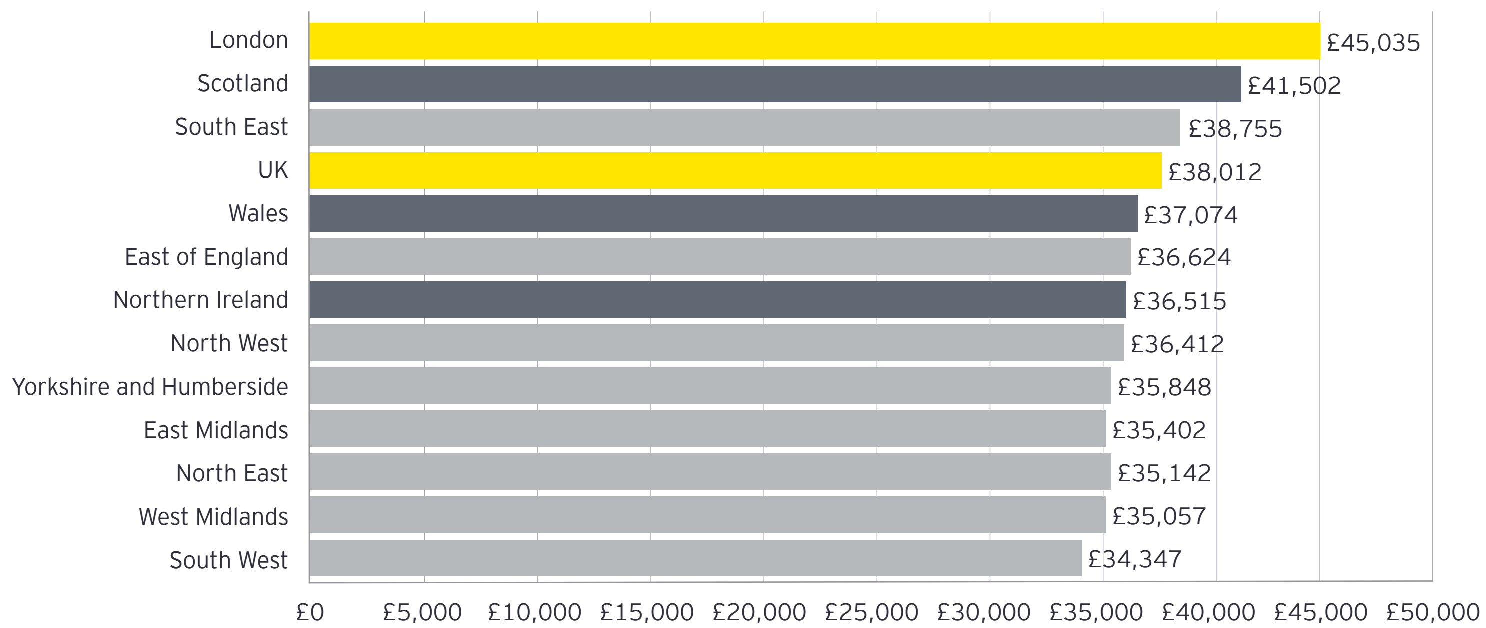
Notably, GVA per employee in the foundational sectors also appears to be significantly higher in London than the rest of the UK. In London, the average GVA per employee across these sectors is £45,035, compared to an average for the UK of £38,012. This advantage does again reflect some London-specific advantages, given its scale and its status as a global tourist destination, which are not replicable. However, again there are variations within regions that could be addressed. Given the importance of the foundational economy in terms of total employment, small incremental improvements in productivity could have material impacts on regional growth and incomes.

**Figure 21:** GVA per employee – high value services – by region – 2022




Source: EY, EY ITEM Club

**Figure 22:** GVA per employee – foundational sector



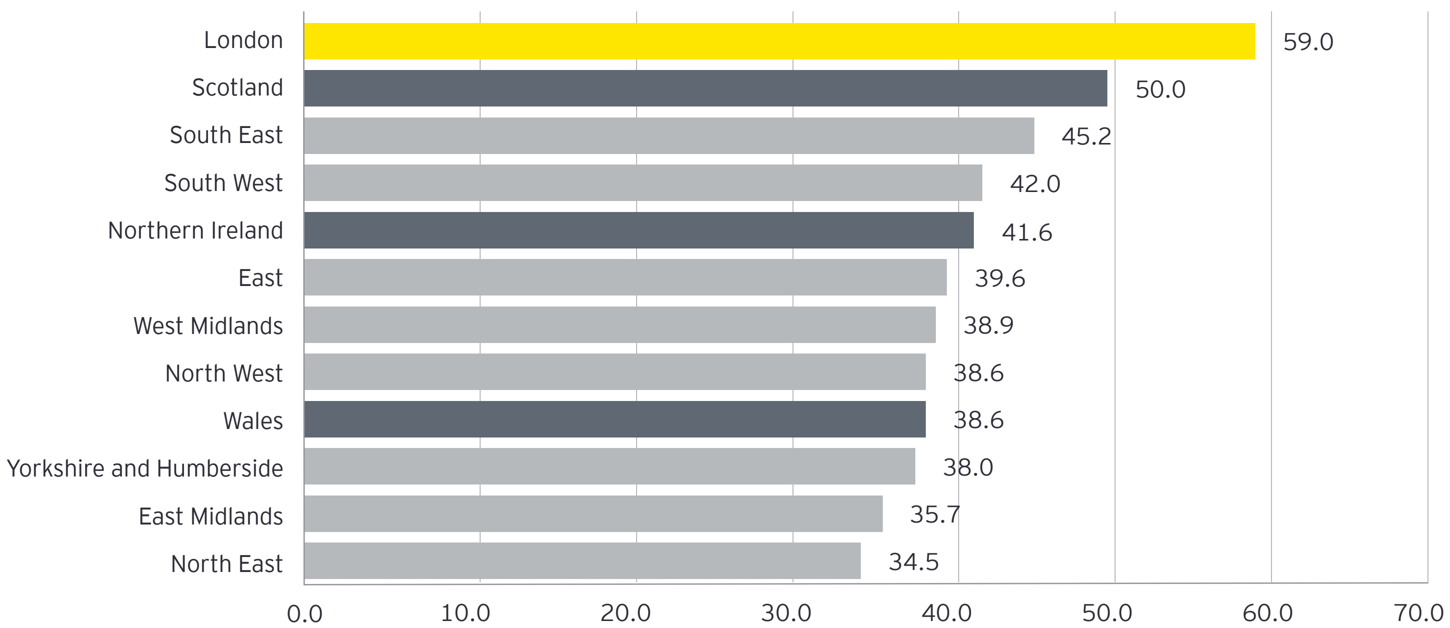

Source: EY, EY ITEM Club

## The North East and the East Midlands have much lower proportions of the workforce holding NVQ level 4 qualifications

**The labour force also matters – with the growth gap between regions partially explained by variations in educational attainment ...**

As demonstrated below, a higher portion of the working age population in London have a qualification level which is at least NVQ Level 4 or equivalent. This skills advantage goes some way in helping to explain why the share of the workforce employed in High-Value Services in London is higher than other regions. In comparison, the North East and the East Midlands have much lower proportions of the workforce holding NVQ level 4 qualifications (34.5% and 35.7 respectively). This suggests that there are opportunities for raising productivity levels regionally, through targeted skills programmes that raise educational attainment levels regionally. The key will be retention of those skills within the region, as there is always the risk that those with highest skills move to follow the opportunities.

**Figure 23:** % with NVQ4+ – aged 16-64 by region – 2021

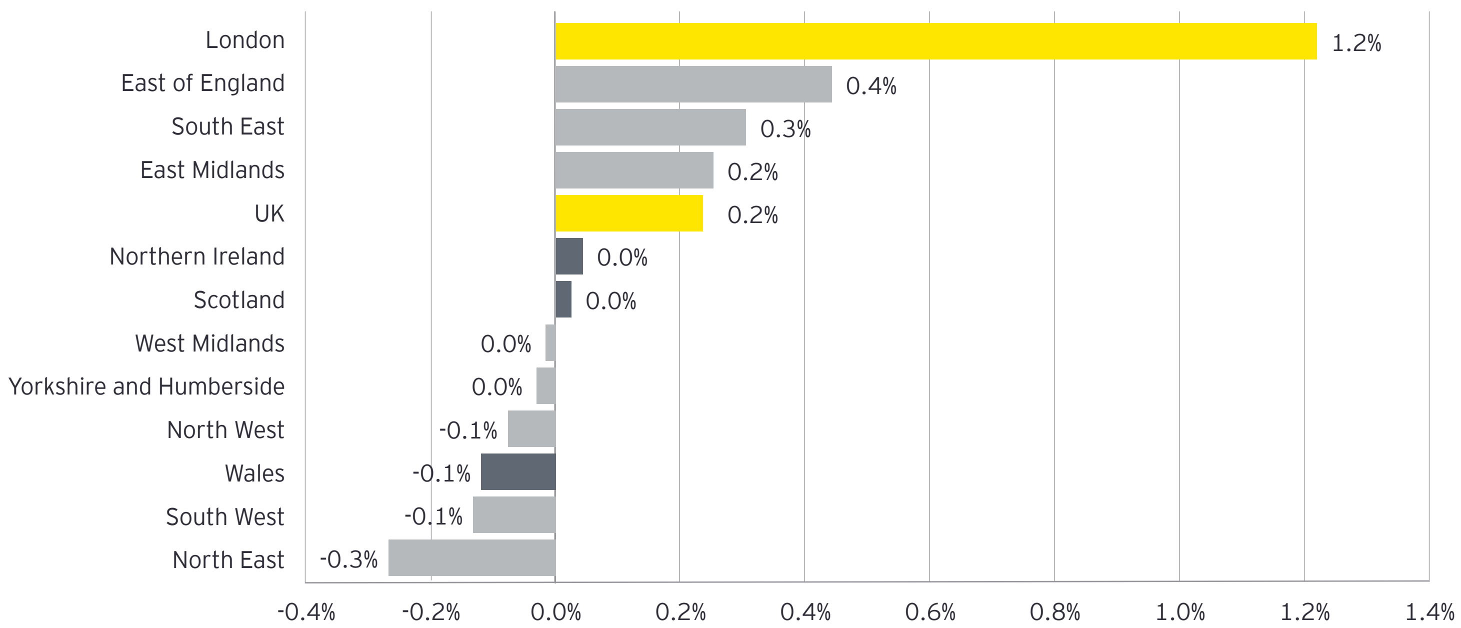



Source: ONS

**... and differences in working age population growth.**

As well as being forecast to have the highest GVA and employment growth, London also has the highest forecast increase in the working age population between 2024 and 2026, with annualised growth of 1.2% forecast for the period. The next highest growing areas are the East of England and the South East, both of which also enjoy higher growth in employment than the other regions. Whilst it is difficult to determine whether high employment growth drives growth in the working age population or vice versa, it is logical to assume that there is a positive relationship between the attractiveness of a region to businesses and employees and employment growth. This has important implications for policy makers, making a region more attractive for the working age population, can have important positive impacts on the growth rate.

**Figure 24:** UK annualised working age population growth by region 2024-2026




Source: EY, EY ITEM Club

# Implications for policy

This year's Regional Economic Forecast points to three opportunities for Policymakers:

**Firstly, a platform is evidenced for Policymakers to have a transformational effect on growth outcomes across the UK.**

The significant volatility faced by regional economies over the last three years, provoked by the pandemic and recent geopolitical events, makes it difficult to delineate between permanent economic trends and temporary factors. It is clear however, despite a record low national unemployment rate (3.7%), economic performance nationally was stagnant across the second half of 2022. This report evidences how the interaction of sector composition and labour markets have shaped recent economic trends. There is therefore a clear platform for effective policy to promote outperformance against forecast by regions.

Economic performance nationally was stagnant across the second half of the year

**Secondly, whilst pandemic traces are evident, the onus of Public and Private actors must now shift to unlocking investment and stimulating innovation.**

The impact of COVID-19 remains demonstrable with several sectors and regions not reaching pre-pandemic output levels, COVID-19 has of course frustrated and deferred Government plans to "level up" the UK economy. The much-heralded white paper arrived early in 2022 – however the political uncertainty in the UK since then, accompanied by challenging global economic circumstance has made building momentum in this respect challenging. Whilst initiatives such as Freeports are in-flight, progress on major capital programmes, industrial strategies and regional economic funding such as UK Shared Prosperity Fund and Stronger Towns Fund are progressing more slowly. The capacity of the public sector as primary financier in driving growth is uncertain, influenced by the additional funding burden accumulated in recent years. This shifts the onus for regional and local leaders, challenging them to unlock private investment and innovation through creative policy design, attractive incentives garnered through devolution, augmented by efficient application of smaller catalytic funding.

**Thirdly, the risk of regional inequalities being reinforced in the coming years demands research and intervention from Policymakers.**

A key finding, that the economic ascendency of London will likely return across the next three years (2.6% GVA output versus UK average of 2.1%) should act as a spur for regional policymakers. The strength of London, and to a lesser extent the South East, is founded in sectoral composition. The higher value-add sectors of the economy account for a higher proportion of output than in any other area, and the London productivity effect, that holds irrespective of foundational or high-value sectors, warrants close research and replication, as does the cultural and social factors that retain high skill labour. Policy makers should evaluate how further spill over and regional benefits can be leveraged from the accelerated growth in the capital.

**In responding to these challenges Policymakers have both fiscal and policy levers available:**

- **Aggressively promoting productivity interventions, particularly in the foundational economy;** in response to tightness in labour markets national policymakers must unlock gains through productivity. Interventions such as provision of preferential or guaranteed finance for business, targeted workforce incentives from promoting digital through to employee wellbeing advice, and strategic plans to accelerate sector productivity should be prioritised.
- **Creating a Private Sector investment imperative;** undertaken from two angles, firstly through the newly formed Department for Business and Trade cementing its role in competing globally to attract new and expansionary FDI, providing the necessary expert facilitation and incentives that define investment decisions. Secondly, working cross-Government to define high-growth investible propositions for each region that can turbocharge research, innovation and growth, a model exemplified best by the 'wall of capital' for net zero articulated in the Skidmore Review.
- **Utilising market intelligence and data to deepen sectoral understanding;** beginning with a longitudinal analysis of megatrends such as AI, net zero and automation to determine their impact on markets. These ramifications must then be mapped to existing capacity, and skills bases at both national and regional level with the findings integrated into high value add sector plans. For example, truly integrating the Net Zero Strategy into planning for coastal communities or manufacturing value chain, and designing local interventions to upskill workers in new energy capabilities that can benefit multiple elements of an economy.
- **At a local level, matching strategic plans with devolution powers to unlock growth;** armed with the knowledge of their region's capabilities and competitive advantages, local policymakers understand how constraints on growth can be liberated through devolution. Deepening powers, finance, and accountability in domains such as skills and employment support, land availability and R&D will facilitate the transition toward a cleaner, greener and more prosperous future for the regions.

**Appendix 1:**
**Sector classifications**

| Sector | Grouping |
|---|---|
| Agriculture, forestry and fishing | Primary |
| Mining and quarrying | Primary |
| Manufacturing | Manufacturing |
| Electricity, gas, steam and air conditioning supply | Utilities |
| Water supply; sewerage, waste management and remediation activities | Utilities |
| Construction | Construction |
| Wholesale and retail trade; repair of motor vehicles and motorcycles | Retail, recreation and leisure |
| Transportation and storage | Foundational |
| Accommodation and food service activities | Retail, recreation and leisure |
| Information and communication | High value services |
| Financial and insurance activities | High value services |
| Real estate activities | Real Estate |
| Professional, scientific and technical activities | High value services |
| Administrative and support service activities | Other |
| Public administration and defence; compulsory social security | Foundational |
| Education | Foundational |
| Human health and social work activities | Foundational |
| Arts, entertainment and recreation | Retail, recreation and leisure |
| Other service activities | Other |





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