OXFORD ECONOMICS

SOLENT LOCAL ENTERPRISE PARTNERSHIP

THE NEW GEOGRAPHY: OUTTURN AND BASELINE FORECASTS

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SOLENT LOCAL ENTERPRISE PARTNERSHIP

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November 2019

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EXECUTIVE SUMMARY

The Solent Local Enterprise Partnership (LEP) remains a major contributor within the South East, accounting for almost 12 percent of the regional economy's GDP. While Solent's recent population growth has been weak, relative to both the wider South East region and the UK as a whole, the working-age share of its population remains above average relative to both.

SECTOR STRUCTURE DRAGS ON JOB GROWTH

We estimate that the LEP's realignment to its new, eight-council area geography has had a minimal impact on the overall employment level, although its public and hospitality sectors have seen their employment shares increase marginally.

The local economy's sectoral structure remains relatively heavy in sectors that are vulnerable to government spending (public administration & defence, education, health), and also in manufacturing, which continues a long-established trend of job losses. Recent Armed Forces related job losses in the Solent have not been as heavy as those experienced throughout the UK. However, its economy remains underrepresented in several faster-growing sectors.

Consequently, local job growth has continued to disappoint over the last six years, increasing at a rate close to a third of the national average.

1.7 percent

The Solent LEP's average annual GVA growth to 2030, according to our baseline forecast.

Only marginally below the UK-wide average over the same period.

PRODUCTIVITY IMPROVEMENTS TO DRIVE GROWTH

Our baseline forecast is for economic growth within the Solent LEP to pick up strongly, only marginally underperforming the UK average, and growing on average by 1.7 percent each year to 2030. We expect much of this to be driven by productivity improvements rather than net additional job creation. High-value sectors will see the largest relative growth in employment terms, thereby helping to boost overall productivity levels within the LEP area. That said, the productivity gap with the rest of the South East region is expected to remain, given the local economy's sectoral characteristics.

While job growth is projected to be weak relative to both the wider regional and UK averages, the LEP's unemployment rate will remain low because of weak population growth within the working-age cohort. However, its declining working-age population share will see the employment rate (for residents aged 16 and over) fall more quickly than in the UK as a whole.

WIDER RISKS TO GENERAL GROWTH

Currently, Brexit continues to loom large on the horizon, with implications for local economies throughout the UK. However, risks are not isolated domestically. We expect the global economic outlook to soften over the coming year, with weaker growth in both the US and China. Meanwhile much of the trade growth enjoyed by UK due in part to the weaker pound is likely to dissipate, therefore the UK economy will rely more heavily on consumer spending to support growth in the coming years.

1. INTRODUCTION

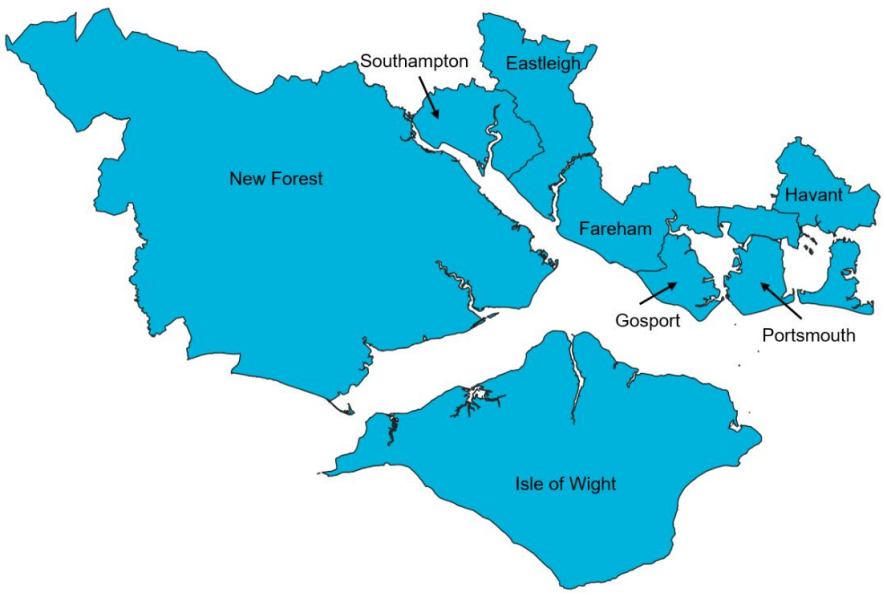
1.1 RECENT BOUNDARY CHANGES

The Solent area is an internationally recognised economic area anchored around the Isle of Wight, the cities of Portsmouth and Southampton, the M27 corridor and the Solent Waterway. Historically, the Solent economy included:

- Eastleigh;
- Fareham;
- Gosport;
- Havant;
- Isle of Wight;
- Portsmouth;
- Southampton;
- New Forest (12 wards);
- East Hampshire (7 wards);
- Test Valley (8 wards);
- Winchester (9 wards); and
- Hampshire County Council as the upper tier authority.

Recently however, the LEP transitioned to a new geographic area definition which we use throughout the analysis in this report. For reference, under the new boundary formation, the wards in East Hampshire, Test Valley, Winchester are removed from the LEP, while the New Forest local authority is included in full. Therefore, Solent now includes eight Local Authorities, with Hampshire County Council as the upper tier authority across the district area.

Fig. 1. The new Solent boundary



1.2 REPORT STRUCTURE

Section 2 of this report provides a discussion of the broader macro-economic outlook affecting the Solent economy.[1]. This includes the recent performance of the world's leading economies including the UK, and some of the pertinent risks associated with the next phase of Brexit negotiations. This analysis reflects the data available in Q1 2019, when it was written. In Section 3 the report lays out the Solent LEP's recent outturn performance in terms of demographics, the labour market, and economic output. Our Q1 2019 forecasts are presented in Section 4 and compared to our 2016 forecasts (for the new Solent geography).

We finish the report with a short discussion of Brexit-related risks in Section 5. This explores both the assumptions underpinning the forecasts presented in this report (taken from our Q1 2019 forecast dataset), how these have changed over time and their subsequent influence in the macroeconomic outlook, and the risks and potential impacts of a 'no deal' Brexit.

[1] This project was originally commissioned in early 2019, and the analysis included in sections 2 to 4 reflect our baseline outlook from the first quarter of 2019.

2. MACROECONOMIC OUTLOOK

2.1 GLOBAL GROWTH HEADWINDS

Global Purchasing Managers' Index (PMI) measures of the strength of economic activity suggest the global economy has been slowing, and financial markets are reflecting rising concerns of a major slowdown in global growth. However, we think market moves are an over-reaction to the weakening economic data. Oxford Economics forecasts global GDP growth to slow from 3.0% in 2018 to 2.7% in 2019, and we expect this slightly slower pace of growth to continue over the medium term.

Fig. 2. GDP growth, world comparators, 2017-2022

	2017	2018	2019	2020	2021	2022	2017-22 y/y
US	2.2%	2.9%	2.5%	1.9%	1.7%	1.8%	2.2%
China	6.9%	6.6%	6.1%	5.8%	5.4%	5.2%	5.8%
India	6.2%	7.4%	7.3%	7.0%	6.8%	6.5%	7.0%
Japan	1.9%	0.8%	1.0%	0.3%	0.9%	0.9%	0.8%
Eurozone	2.5%	1.8%	1.5%	1.6%	1.4%	1.3%	1.5%
UK	1.8%	1.4%	1.7%	2.0%	2.1%	2.0%	1.8%
World	**3.0%**	**3.0%**	**2.7%**	**2.7%**	**2.7%**	**2.7%**	**2.8%**

Source: Oxford Economics

The US remains a major driver of global growth—boosted by the presidential tax stimulus, which has helped to support the global economy by increasing demand for imports. Meanwhile China, the world's second-largest economy, continues to grow at an annual rate of around 6.6 percent in real terms—strong growth by western standards, but weak in comparison to the double-digit growth rates it experienced for much of the last decade. We expect the tariff war between China and the US to dampen the export component of China's growth. Other risks include weaker domestic demand due to slowing consumer demand, and weaker real estate activity.

Weaker growth in China will also impact other emerging economies due to reduced demand for their output, especially the raw materials that have fed China's economic expansion. Equally, these economies are vulnerable to the disruptions in international supply chains which can result from trade conflicts.

Closer to home, recent economic data for the Eurozone has been weaker than expected, with risks to growth. The real growth rate fell to 0.2 percent in the third quarter of last year, the weakest level in five years. Furthermore, the prominent German car industry has suffered recent disruption, following the introduction of new emissions testing procedures. Rising energy prices have also helped to drive inflation across the Eurozone, thereby restricting household disposable income growth and weakening domestic demand.

As a result, the European Central Bank (ECB) has hinted that interest rate rises may be further delayed. The ECB has not yet managed to return to

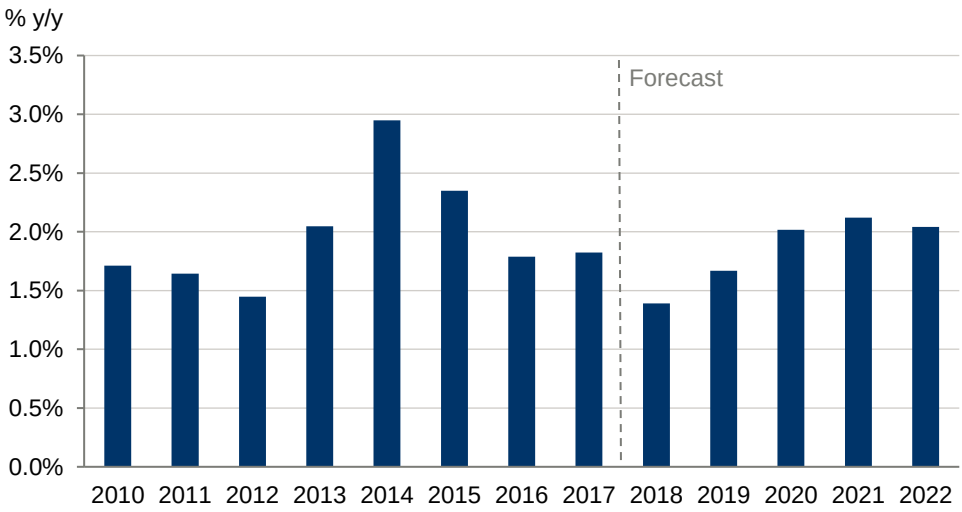
conventional monetary policy since the financial crisis—with the main interest rate still set at zero a decade later.

International factors undermining the Eurozone outlook include the slowdown in China, and the declining stimulus impact resulting from President Trump's tax cuts in the US. Headwinds discouraging global growth are also present in the form of the threat of trade protectionism, and the current lack of clarity within the Brexit negotiations.

2.2 UK OVERVIEW

The UK continues to lose momentum amid all the Brexit-related uncertainties. Manufacturing surveys suggest that firms are engaging in precautionary stock building to guard against potential supply chain disruption in the event of a 'no deal' outcome. Equally, services have reported that Brexit-related uncertainty has weighed on business-to-business demand. Stronger global growth and a weak pound drove a marked pick up in UK export growth in 2017—but the boost from these factors petered out in 2018. We estimate Q4 GDP growth to finish 2018 at 0.3 percent, a six-month low. This would mean that 2018 experienced GDP growth of just 1.4 percent, the lowest rate since 2010.

Fig. 3. Real GDP growth, UK, 2010-22



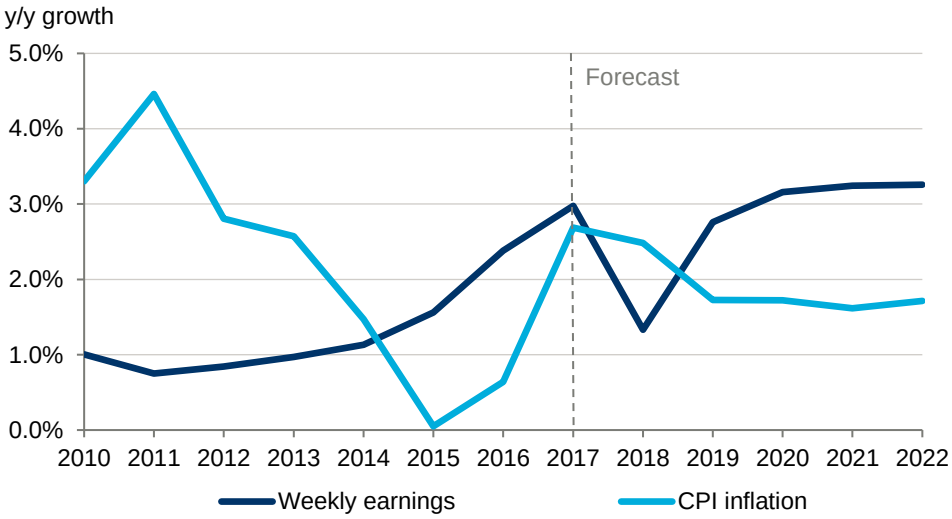
Source: Oxford Economics

Lower inflation and a looser fiscal stance by the UK government would support a pick-up in activity through 2019. However, this relies in part on the UK achieving an "orderly" exit from the EU.

We expect GDP growth to pick up to 1.7 percent this year, and 2.0 percent in 2020. Household spending power will be a driver of this uplift, as last year's inflationary pressures (caused by higher oil prices, rises in domestic energy bills, and the continued weakness in sterling) diminish. In 2019, inflation should continue its decent following the recent fall in oil prices and amid expectations that sterling will strengthen once the Brexit deal is approved. We expect CPI inflation to fall to 1.7 percent, from 2.5 percent in 2018. Stronger wage growth

will support household spending power, although there may be some offsetting effects from the government's welfare reforms and higher interest rates.

Fig. 4. Earnings and inflation, UK, 2010-22



Source: Oxford Economics

Indeed, the minutes from December's Monetary Policy Committee (MPC) meeting at the Bank of England repeated the claim that future interest rate changes are on hold pending Brexit developments. Therefore, in the event of an orderly Brexit, the MPC seems set on continuing to pursue the normalisation of the UK's monetary environment, by raising interest rates above their current low levels. We believe the incoming data on earnings and inflation will be followed by a 25bp rate hike at some stage in 2019, taking the UK bank rate up to 1.0 percent.

Favourable revisions within the Office of Budget Responsibility (OBR) borrowing forecasts have allowed the Chancellor to loosen his fiscal stance in 2019-20, with higher government spending and generous increases in the income tax thresholds. Therefore, fiscal policy should offer some support to GDP growth this year.

Although UK firms are in solid financial shape, they have been reluctant to invest, with business investment falling in each of the first three quarters of 2018. This trend is likely to continue until the UK's trading relationship with the EU is finally agreed. We therefore expect UK business investment growth to pick up only slowly, to 1.1 percent in 2019, and 2.5 percent the following year.

3. SOLENT OUTTURN PERFORMANCE

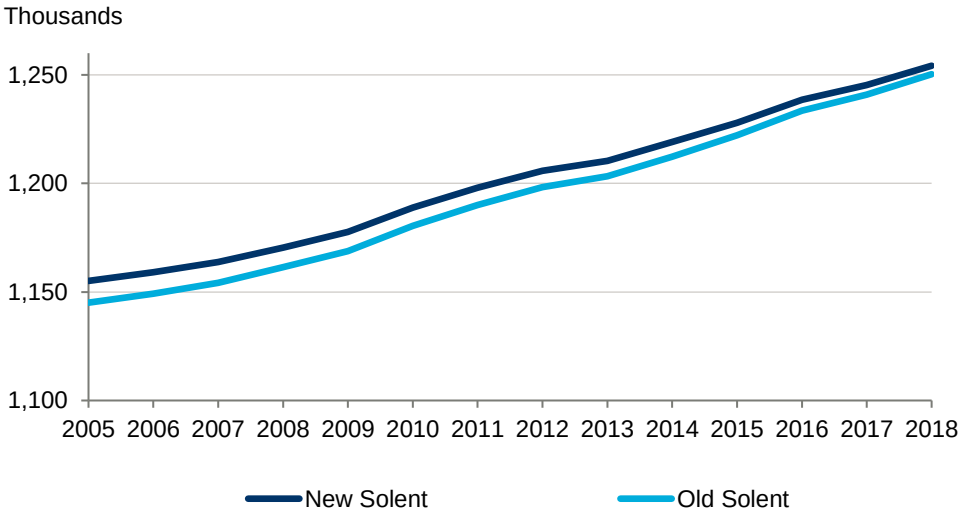
This chapter provides an assessment of recent performance in the Solent LEP economy. The analysis concentrates on the key themes of demographics, labour market and economic output, in addition to a breakdown of performance within the constituting local authority areas.

3.1 DEMOGRAPHICS

Solent's population level stood at 1.2 million in 2018, accounting for almost 14 percent of the South East's regional total. A comparison between Solent's old and new LEP geographies shows relatively little change in the overall population level following this boundary change. We estimate the new geography is 0.3 percent larger in population terms, with an additional 4,000 residents.

Recent population growth in the Solent LEP has underperformed both the regional and national averages—albeit by only a small amount. Solent's population grew by an average of 0.66 percent per annum between 2012 and 2018; weaker than the 0.72 percent and 0.81 percent growth experienced nationally and in the South East, respectively.

Fig. 5. Population levels, Old vs. New Solent boundary, 2000-18

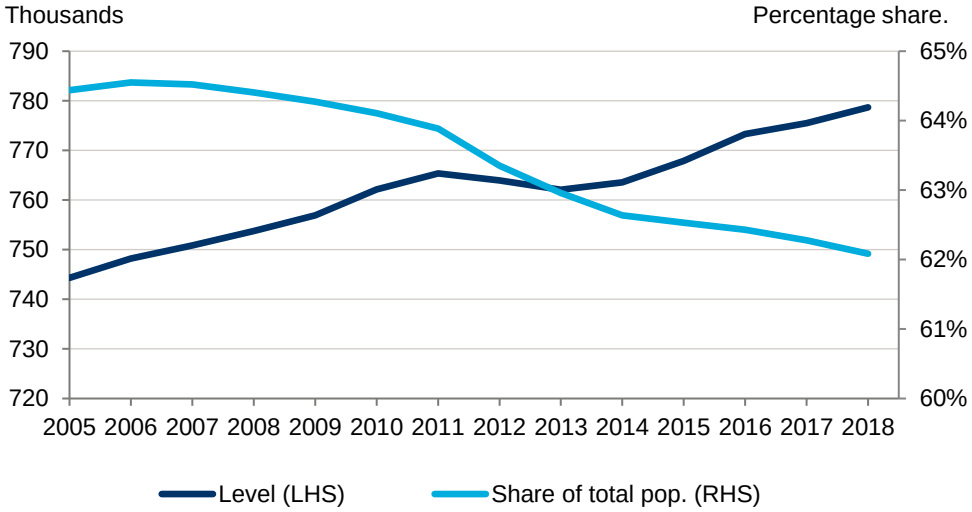


Source: Oxford Economics

The working-age share of overall population is an important indicator of economic potential—and Solent's working-age population share, though still above average, has been falling. In 2018, the cohort aged 16 to 64 accounted for 62.1 percent of its total population—stronger than both the regional (59.5 percent) and UK (60.8 percent) averages. But the UK's demographics are ageing, with implications for the available pool of working-age people, and in Solent, this share of the total population has contracted by over two percentage points in the last decade alone.

The latest census data show that people aged 65 and over accounted for one-in-four residents of the Isle of Wight, for example, compared to one-in-six for England as a whole. Furthermore, ONS population estimates for 2017 show that, with the exception of Portsmouth and Southampton, all of the Solent LEP's council areas had above-average cohorts aged in the 65+ range.

Fig. 6. Working-age population (aged 16-64), Solent LEP, 2005-18



Source: Oxford Economics

Southampton and Portsmouth are the LEP's two largest local authorities when measured in population and working-age population terms. Furthermore, they recorded the fastest rates of growth according to both metrics, over the period 2012 to 2018. (Interestingly, Portsmouth experienced the second-fastest population and working-age population growth rates despite recording job losses over the period. We discuss this phenomenon in more detail later in this report.)

Both the Isle of Wight and New Forest experienced a fall in the number of residents of working age over the period, while Eastleigh's working age population level remained unchanged (see Fig. 7).

Fig. 7. Population components, Solent's local authority areas, 2012-18

	Population, 000s			Working age, 000s		
	2012	2018	%y/y	2012	2018	%y/y
Eastleigh	127	132	0.60%	81	81	0.00%
Fareham	113	117	0.59%	69	70	0.22%
Gosport	83	86	0.56%	52	53	0.17%
Havant	121	126	0.62%	73	74	0.30%
Isle of Wight	139	142	0.34%	82	80	-0.31%
Portsmouth	207	217	0.78%	140	146	0.67%
Southampton	238	255	1.12%	165	174	0.95%
New Forest	178	181	0.27%	102	100	-0.31%
Solent	**1,206**	**1,254**	**0.66%**	**764**	**779**	**0.32%**
South East	**8,725**	**9,158**	**0.81%**	**5,172**	**5,448**	**0.87%**
UK	**63,705**	**66,492**	**0.72%**	**38,389**	**40,428**	**0.87%**

Source: Oxford Economics

The latest data for 2018 show net-migration inflows into Solent running at almost 7,000 people per year. Net migration into the LEP has remained positive, yet volatile, over the last decade—with levels peaking in 2010 and 2016. In both years, over 8,000 more people moved into the area than left it for elsewhere.

Net inward migration flows have increased across all of the Solent's local authority areas except Fareham and Gosport, where levels have remained broadly unchanged between 2012 and 2018. Portsmouth experienced the largest change in net migration levels—going from a net out-migration area in 2012 to having 1,000 more people moving in than leaving in 2018.

Overall, Solent's net migration as a share of the total population level stood at 0.59 percent in 2018, broadly matching that of the South East but exceeding the UK as a whole (0.4 percent). The relative net migration inflows were above the regional average in Fareham, the Isle of Wight, and New Forest.

Fig. 8. Net-migration, Solent's local authority areas, 2012 and 2018

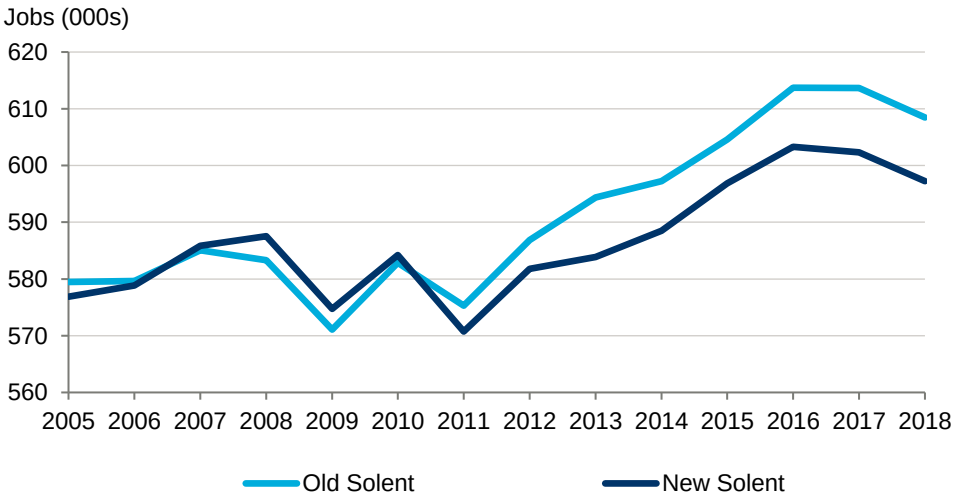
	2012		2018	
	000s	As a % of pop.	000s	As a % of pop.
Eastleigh	0.3	0.26%	0.5	0.41%
Fareham	0.9	0.82%	0.9	0.76%
Gosport	0.4	0.42%	0.4	0.45%
Havant	0.4	0.34%	0.8	0.61%
Isle of Wight	0.8	0.55%	1.2	0.85%
Portsmouth	-0.1	-0.03%	1.0	0.45%
Southampton	1.0	0.44%	1.2	0.47%
New Forest	1.1	0.63%	1.5	0.83%
Solent	**4.9**	**0.40%**	**7.4**	**0.59%**
South East	**39.7**	**0.46%**	**56.7**	**0.62%**
UK	**165.5**	**0.26%**	**270.0**	**0.41%**

Source: Oxford Economics

3.2 LABOUR MARKET

In 2018, workplace employment in Solent stood at 597,000, and accounted for just under 13 percent of the South East region's total. In comparison, the equivalent figure for the old Solent geography was two percent larger, or an additional 11,000 jobs (see Fig. 9).

Fig. 9. Workplace employment, old vs. new Solent boundary, 2005-18

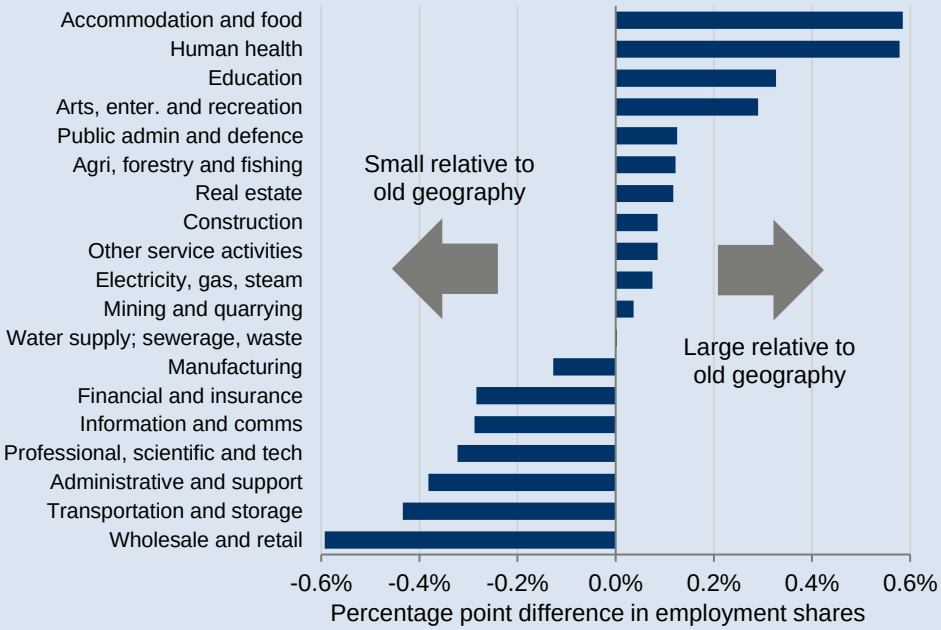


Source: Oxford Economics

UNDERSTANDING SECTORAL STRUCTURE: NEW VS OLD SOLENT

The new Solent area's economy is comparatively more dependent on the health, accommodation & food, and education sectors, and less dependent on retail, transport & storage, and private services (spanning information & communications, finance, and professional services).

Fig. 10. Sectoral employment share differences, new vs. old Solent boundary, 2018



Source: Oxford Economics

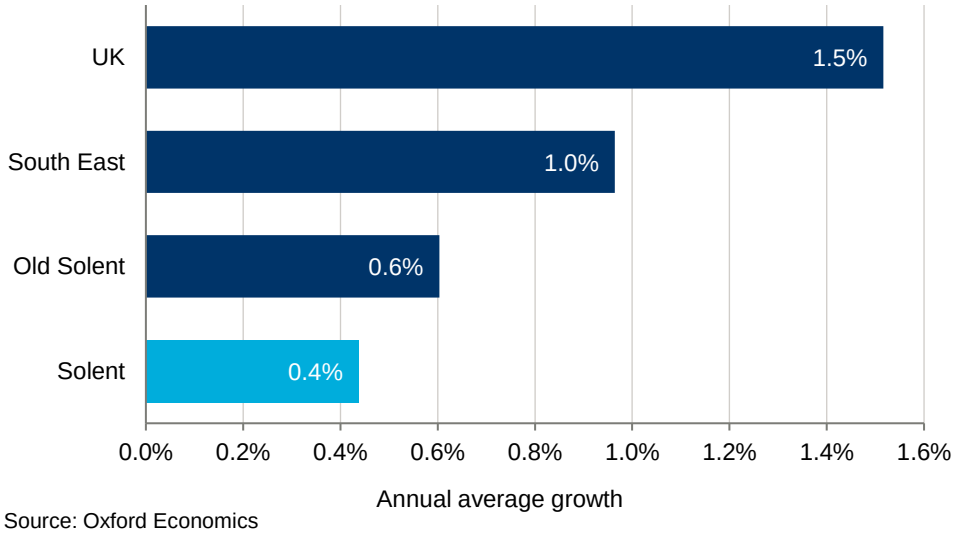
Employers lost to the Solent LEP include those based in Winchester's Solent Business Park, including the Croma Security Solutions group and Oscar Mayer's food manufacturing activities. Other prominent employers now falling outside the LEP include the Zurich Insurance Group's head office, and the NATS corporate and technical centre, based in the Whiteley area.

More generally, the LEP's wholesale & retail and administrative & support sectors experienced the largest absolute change in employment levels following the boundary change—with 8,000 fewer jobs in the new geography. In percentage terms, the finance & insurance and transportation & storage sectors experienced the largest relative declines in employment following the boundary change, falling by 12 percent and 10 percent respectively.

Gains in other sectors were too little to fully compensate, and were concentrated in the accommodation & food and health sectors, collectively hosting an additional 4,700 jobs in the LEP. The boundary change has therefore led to the Solent economy seeing slightly increased concentrations of employment within its public sector and hospitality industries.

Between 2005 and 2011, Solent's workplace employment levels were volatile. Since then, however, the Solent LEP has enjoyed more consistent expansion, with employment growth between 2012 and 2018 averaging 0.4 percent per annum, or nearly 15,500 additional jobs over six years. Nonetheless, the LEP continues to underperform the UK average by this metric, registering employment growth only a third of the national average from 2012-18, and comfortably below that of the South East overall (Fig. 11).

Fig. 11. Workplace employment, Solent and comparators, 2012-18

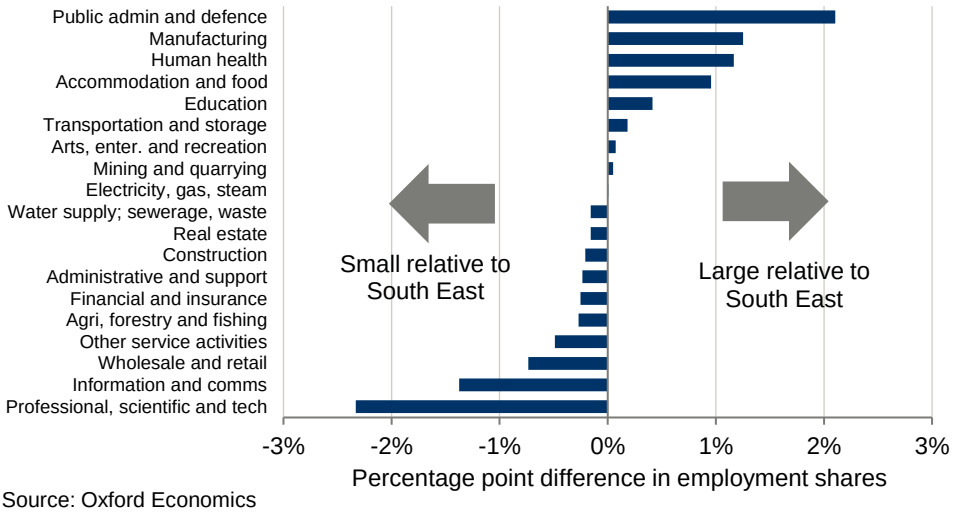


Source: Oxford Economics

Much of this slower growth is due to the Solent LEP's sectoral structure. Its economy has prominent employment shares in slower-growing sectors including both public administration & defence and manufacturing. In contrast, faster-growing private services are generally unrepresented locally. This is particularly the case within the professional, scientific & technical services sector, whose local employment share is almost 30 percent smaller than the regional average.[2]

[2] Professional, scientific & technical services employment accounted for six percent of Solent's total workforce employment in 2018. The same sector represented almost nine percent of the South East region's total employment in the same year.

Fig. 12. Sectoral employment structure, Solent vs. South East, 2018



Source: Oxford Economics

Across the UK, private services have been driving recent growth, with professional, scientific & technical services and information & communications among the strongest-performing sectors. However, Solent's smaller-than-average concentration of employment in these sectors means there has been limited job creation.[3]

The local accommodation & food sector is boosted by Solent's tourism appeal, while its transport & storage sector is marked by strong concentrations of both passenger- and freight-related water transport activity. Prominent health sector-related employment is supported by activity within Southampton University hospital, which provides health services for a catchment area that extends far beyond Solent itself. Health sector employment in Southampton accounted for over a quarter of the total health sector employment in the LEP area in 2018.

Public administration & defence sector job losses have not been as strongly felt as across the region as a whole—influenced, to a degree, by the Navy's concentration within the Solent LEP. The armed forces represent 30 percent of workforce employment in the LEP's public administration & defence sector, much stronger than that experienced in the South East generally (22 percent). And while local naval personnel numbers fell by three percent over the five years since 2012, this decline was significantly weaker than that experienced by the UK as a whole (11 percent). This is likely to be partly related to the arrival of new aircraft carriers at the Portsmouth naval base, and the very large outfitting process that is currently underway there.

The Solent LEP's large fall in manufacturing employment reflects a wide range of job losses—not least the closure of Ford's assembly plant in Southampton in 2013—along with the effects of the broad decline in defence procurement.

[3] Although employment in the information & communication sector as a whole is relatively underrepresented within Solent, this disguises the LEP's strong employment specialism within 'wired telecommunications activities'.

Fig. 13. Sectoral employment change, Solent and comparators, 2012-18

	Solent LEP		South East		UK	
	000s	% y/y	000s	% y/y	000s	% y/y
Agri, forestry and fishing	-0.9	-3.1%	-5.1	-1.7%	-15	-0.6%
Mining and quarrying	0.0	-0.2%	-4.1	-17.3%	-14	-3.3%
Manufacturing	-10.1	-3.6%	-5.8	-0.4%	139	0.9%
Electricity, gas, steam	0.9	6.3%	3.4	2.8%	25	3.2%
Water supply; sewerage, waste	0.8	4.0%	12.2	6.8%	32	2.6%
Construction	6.2	2.6%	69.3	3.6%	294	2.2%
Wholesale and retail	-6.8	-1.3%	-26.0	-0.6%	107	0.4%
Transportation and storage	0.1	0.1%	16.9	1.3%	187	2.0%
Accommodation and food	7.7	3.1%	55.8	3.2%	373	2.8%
Information and comms	3.9	2.6%	27.4	1.7%	318	3.9%
Financial and insurance	-1.5	-1.6%	-4.8	-0.6%	-22	-0.3%
Real estate	1.6	3.5%	4.2	1.0%	77	2.4%
Professional, scientific and tech	0.4	0.2%	-0.2	0.0%	473	2.9%
Administrative and support	1.1	0.4%	4.4	0.2%	373	2.2%
Public admin and defence	-2.3	-1.1%	-15.1	-1.4%	-67	-0.7%
Education	4.7	1.4%	44.1	1.7%	175	1.0%
Human health	4.8	1.0%	66.1	2.0%	367	1.5%
Arts, enter. and recreation	1.8	1.7%	8.1	1.0%	127	2.2%
Other service activities	3.0	3.4%	13.9	1.6%	78	1.4%
Total	**15**	**0.4%**	**265**	**1.0%**	**3,028**	**1.5%**

Source: Oxford Economics

At a local level, there have been contrasting fortunes. Southampton enjoyed net employment creation of 8,200 over the 2012-18 period, while Portsmouth lost 3,500 net jobs. Interestingly, while three local areas (Eastleigh, Havant, and Southampton) outperformed the South East region's average employment growth over the period, none could match the UK average. Furthermore, three of Solent's eight local authorities experienced net job losses.

Eastleigh is the only local authority within the LEP to have a relatively large professional services sector in employment terms, compared to the South East as a whole. All three of the faster-growing local economies had below-average public administration & defence sector exposure, but only Southampton had a below-average share of workplace employment in the manufacturing sector.[4]

[4] See the Appendix for charts relating to sectoral structure breakdown among Solent's local authority areas.

Fig. 14. Workplace employment, Solent's local authority areas, 2012-18

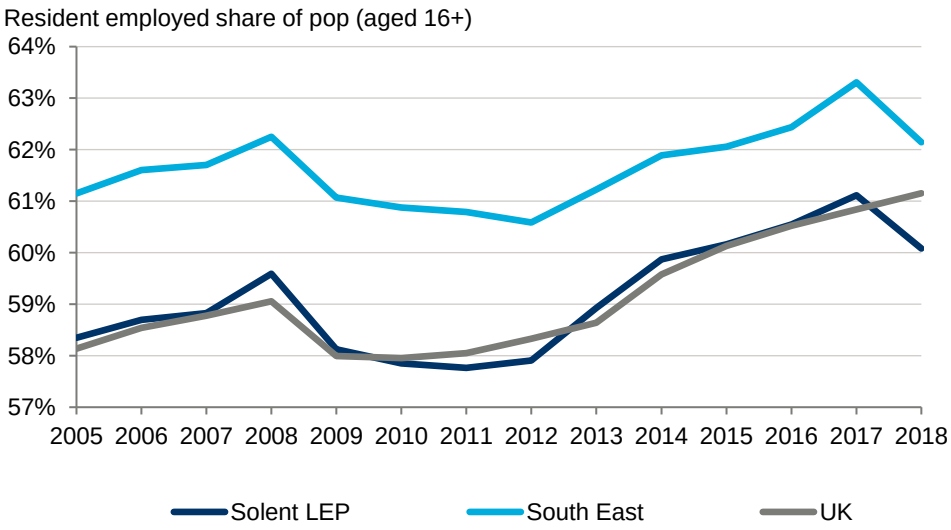
	Workforce jobs (000s)		Change	
	2012	2018	000s	% y/y
Eastleigh	71	77	5.7	1.3%
Fareham	57	56	-0.6	-0.2%
Gosport	25	26	1.1	0.7%
Havant	48	52	3.6	1.2%
Isle of Wight	58	60	1.4	0.4%
Portsmouth	124	120	-3.5	-0.5%
Southampton	118	126	8.2	1.1%
New Forest	81	80	-0.5	-0.1%
Solent	**582**	**597**	**15**	**0.4%**

Source: Oxford Economics

Solent's employment rate has outperformed the South East in recent years, increasing by 2.2 percentage points over the six-year period since 2012, compared to only 1.6 percentage points for the wider region. Despite this, Solent's employment rate stood at 60 percent in 2018—just below the UK average, and weaker than the South East overall (62 percent).

Fareham, Gosport, and Portsmouth have all experienced falls in their employment rates since 2012. Eastleigh experienced the largest improvement, growing by almost nine percentage points to reach 71 percent in 2018.

Fig. 15. Employment rate, Solent and comparators, 2005-18



Source: Oxford Economics

At the same time, unemployment has continued to fall in Solent, dropping to 3.5 percent in 2018[5]—lower than both the UK (4.1 percent) and South East (3.6 percent) averages (see Fig. 16). The fall in Solent's unemployment rate over the last six years has been just as strong as that experienced across the South East. However, this has coincided with a pick-up in net out-commuting levels across the LEP—as relatively weak local employment growth is likely to have led to the unemployed looking further afield for employment opportunities.

Over the last six years, unemployment rates have fallen in all of Solent's local authority areas bar Eastleigh, which has experienced a 1.7 percentage point increase.

Fig. 16. Economic activity and inactivity, Solent's Local Authority areas, 2012 and 2018

	Resident employment rates			Unemployment rates			Inactivity rates (16-64s)
	2012	2018	% pt change	2012	2018	% pt change	2017
Eastleigh	63%	71%	8.6%	2.7%	4.5%	1.7%	13.7%
Fareham	62%	61%	-0.3%	6.5%	3.1%	-3.5%	15.9%
Gosport	59%	56%	-3.2%	7.0%	4.4%	-2.7%	23.8%
Havant	55%	60%	4.7%	6.5%	2.2%	-4.3%	19.2%
Isle of Wight	52%	56%	3.6%	8.0%	4.3%	-3.7%	23.3%
Portsmouth	57%	57%	-0.3%	8.4%	3.7%	-4.7%	23.7%
Southampton	58%	61%	3.3%	7.7%	3.8%	-4.0%	23.1%
New Forest	58%	58%	0.2%	3.9%	2.0%	-1.9%	18.0%
Solent	**58%**	**60%**	**2.2%**	**6.5%**	**3.5%**	**-3.0%**	**20.2%**
South East	**61%**	**62%**	**1.6%**	**6.3%**	**3.6%**	**-2.8%**	**18.6%**
UK	**58%**	**61%**	**2.8%**	**8.0%**	**4.1%**	**-3.9%**	**21.8%**

Source: Oxford Economics, ONS

Note: Both employment and unemployment rates are as a share of those aged 16+

The latest ONS data show that, although "inactivity" has fallen among Solent's working-age population since 2012, the share remains above average relative to the wider region.[6] In 2017, just over 20 percent of 16-to-64 year olds were neither employed nor looking for work—compared to 18 percent across the South East as a whole. However, there is great variance within Solent: for example, the inactivity rate is quite low in Eastleigh, helping to explain why unemployment rates are above the LEP average, given the otherwise relatively high employment rate. Conversely, inactivity rates are all well above the UK average in Gosport, the Isle of Wight, and Portsmouth. ONS survey data indicate that almost 90 percent of the inactive cohort in Gosport do not want a job, with high concentrations of retirees evident. Meanwhile, a high proportion

[5] Using the International Labour Organisation (ILO) definition which is a more direct assessment of unemployment, rather than those who claim benefits.

[6] The economically inactive are defined as working age people who are not in employment or unemployed. There are numerous reasons for being inactive, including studying, sickness or looking after family.

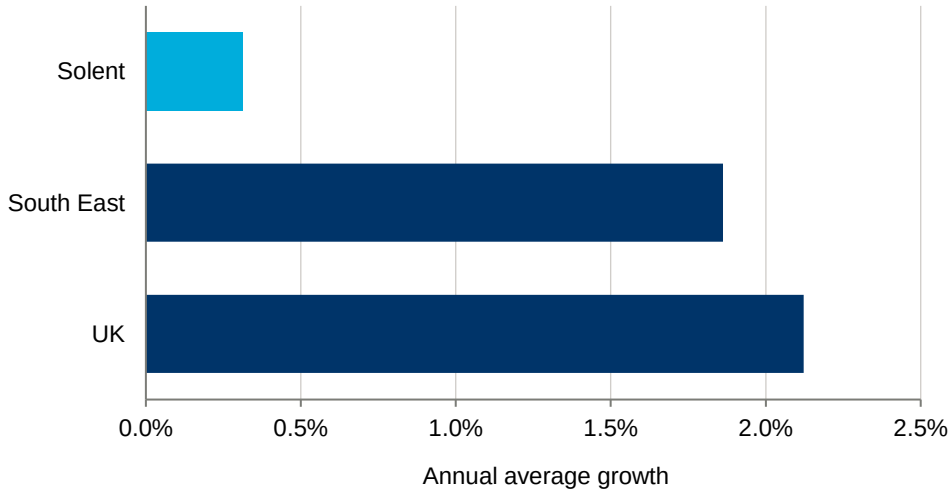
of the working-age inactive in the Isle of Wight and Portsmouth are made up of the long-term sick and students, respectively.

3.3 ECONOMIC OUTPUT

We estimate the total value of goods and services (GVA) produced within Solent's economy in 2018 at £30.6 billion (2016 prices).[7] The LEP therefore accounts for 12 percent of the South East region's total output. The size of the Solent economy under its new boundary was only slightly smaller (2.7 percent) than under the old definition, whose total GVA for 2018 would have been £31.4 billion (2016 prices).

Solent's recent GVA growth has been relatively weak, however, averaging 0.3 percent per year from 2012 to 2018—well below the equivalent regional and national averages of 1.9 and 2.1 percent respectively.

Fig. 17. GVA growth, Solent and comparators, 2012-18

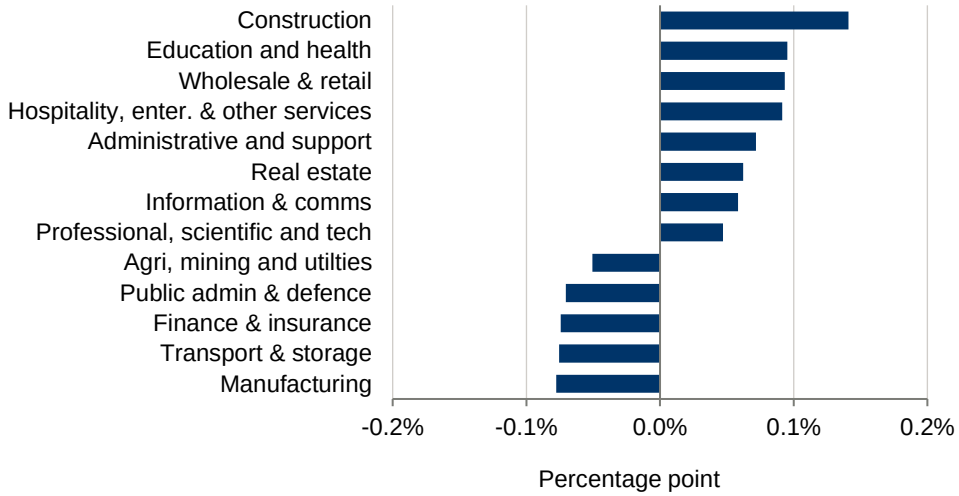


Source: Oxford Economics

A sectoral breakdown (see Fig. 18) shows that this relative underperformance in GVA growth was due to contractions in output in several of Solent's key sectors. Of these, the most significant brake to overall growth has been a contraction in manufacturing output—dropping by close to 10 percent between 2012 and 2018. Absolute falls of a similar size to manufacturing, were recorded in Solent's public administration & defence, transport & storage, and finance sectors—although in relative terms, the declines were much larger in these sectors at 17 percent, 12 percent, and 22 percent respectively.

[7] Gross Value Added (GVA) is the difference between the value of goods and services produced by a business or a sector, and the cost of the raw materials and other inputs used up in production. It is essentially a measure of the value added to the services or products provided by a sector or firm. Figures are presented in constant prices to remove the influence of inflation.

Fig. 18. Sectoral contribution to GVA growth, Solent, 2012-18



Source: Oxford Economics

At a more local level, Southampton again recorded the fastest growth, with its GVA expanding by an annual average of 1.8 percent over the period 2012 to 2018—notably faster than the Solent LEP's average, and close to the regional average. Eastleigh and the Isle of Wight also recorded notable levels of GVA growth.

In contrast, GVA contracted over the period in Havant, New Forest, and Gosport. But Portsmouth, despite experiencing net job losses, managed to avoid a contraction in GVA due to productivity improvements—whereas the LEP as a whole experienced falling productivity.

Fig. 19. GVA, Solent's local authority areas, 2012-18

	GVA (£2016m)		Change	
	2012	2018	£2016m	%y/y
Eastleigh	3,888	4,284	396.7	1.6%
Fareham	2,734	2,782	48.3	0.3%
Gosport	1,028	956	-71.9	-1.2%
Havant	3,178	2,771	-406.3	-2.3%
Isle of Wight	2,610	2,840	229.4	1.4%
Portsmouth	5,606	5,697	91.1	0.3%
Southampton	6,286	6,990	704.3	1.8%
New Forest	4,676	4,251	-425.3	-1.6%
Solent	**30,005**	**30,571**	**566**	**0.3%**

Source: Oxford Economics

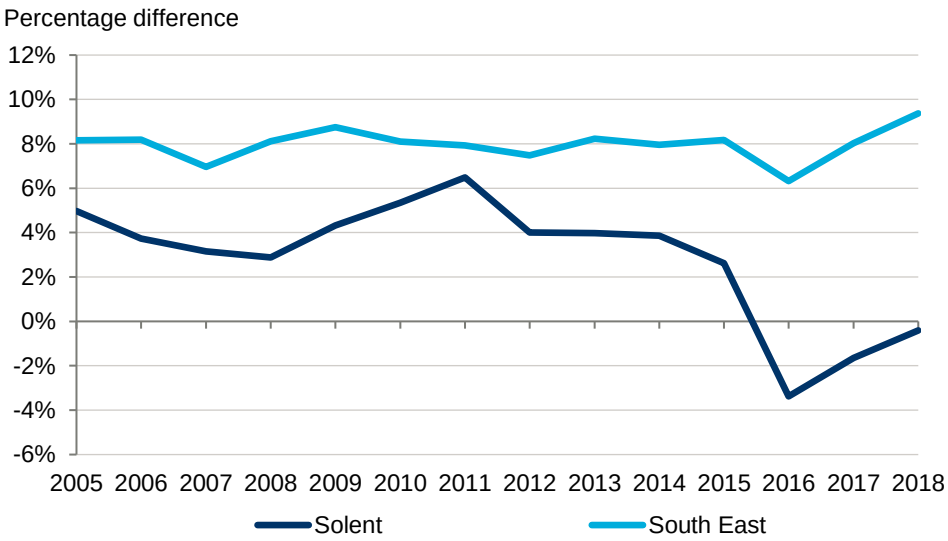
Employment is just one factor in the economic growth equation. The other, productivity, has seen relatively poor growth for the UK as a whole over the last decade, compared to the gains experienced before the financial crisis. The latest data show that relatively weak productivity growth has dragged overall economic growth within the LEP area. Output per person in Solent fell marginally between 2012 and 2018, whereas the South East and UK levels increased by 5.5 percent and 3.6 percent respectively.

Despite evidence of continued restructuring, the Solent economy continues to exhibit above-average concentrations of employment, relative to the wider region, in a range of less-productive sectors (public administration, manufacturing, and accommodation & food). Equally, the economy has experienced lacklustre job growth in higher value-added sectors including both professional services and information & communications, which have not enjoyed the same growth as has been observed across the UK. Indeed, the accommodation & food sector created the highest number of additional jobs in the Solent LEP between 2012 and 2018.

For much of the last decade, the Solent economy has experienced a productivity gap between itself and the rest of the South East—while remaining more productive than the UK overall (see Fig 20). However, recent subdued productivity growth has seen Solent's productivity level converge with the UK average, meaning the productivity gap to the South East region has widened.

The Solent LEP's average productivity per job in 2018 is estimated at £51,200 (2016 prices) —on a par with the UK average (£51,400), but underperforming the regional average by almost nine percent (£56,200).

Fig. 20. Solent and South East productivity gaps relative to the UK as a whole, 2005-18



Source: Oxford Economics

3.4 SUMMARY

The Solent LEP is home to almost 14 percent of the South East's total population. However, its population growth has been relatively weak in recent years, and the working-age share of its total population has been falling consistently since 2007.

There are over 597,000 workforce jobs within the LEP as defined by its new boundary—only slightly fewer than under the old definition. Under the new geography, the Solent economy has seen comparatively increased employment concentrations within the public and hospitality sectors.

Recent job growth has been relatively disappointing, weighed down by losses within the local manufacturing and retail sectors. Furthermore, productivity growth has been relatively stagnant. Together, these factors have contributed to local economic output growth trailing both the regional and national averages.

While Solent's employment and unemployment rates have both improved over the last six years, they still trail those of the wider South East region, on average.

At a local level, there are contrasting fortunes. Southampton has enjoyed the fastest rates of growth for population, working-age population, and GVA. Eastleigh was the fastest growing in employment terms, and second-fastest with regards to GVA growth. Portsmouth, the second-largest area in population terms, has suffered notable job losses since 2012. But productivity improvements mean its GVA has grown over the period, albeit slowly.

4. SOLENT BASELINE FORECAST

This chapter provides a summary of our baseline forecast for the Solent LEP area out to 2030, and fully reflects our post-Brexit view of the likely path of the economy. The analysis given below compares our forecasts for the LEP against the performance of the South East, the UK and our Winter 2016 outlook for new Solent geography.[8]

4.1 DEMOGRAPHICS

Oxford Economics expects Solent's population to increase by nearly five percent by 2030, or by 64,000 over the 12-year outlook. Population growth will therefore match what is expected across the UK, but will be weaker than for the wider South East region. The current population outlook is therefore only marginally weaker than that of our Winter 2016 outlook for the LEP area.

Fig. 21. Population change, Solent and comparators, 2018-2030

	Total population		Population - aged 16-64	
	000s	% y/y	000s	% y/y
Solent	64	0.42%	1	0.01%
Solent (2016 forecast)	67	0.43%	-12	-0.13%
South East	601	0.53%	256	0.38%
UK	3,425	0.42%	1,416	0.29%

Source: Oxford Economics

We expect Southampton to continue to record the fastest rates of population and working-age population growth over the forecast period (see Fig 22). While population growth in Portsmouth is expected to match the regional average, its working-age rate will be notably slower. Furthermore, over the forecast period to 2030, we forecast that five of Solent's eight local authorities will experience falls in their working-age populations, with a sixth, Eastleigh, remaining relatively unchanged.

[8] Based on Oxford Economics' 2016 forecast release. This baseline outlook was used to inform the analysis within our previous report - "Solent Local Enterprise Partnership: Baseline forecasts and the implications of Brexit, January 2017"

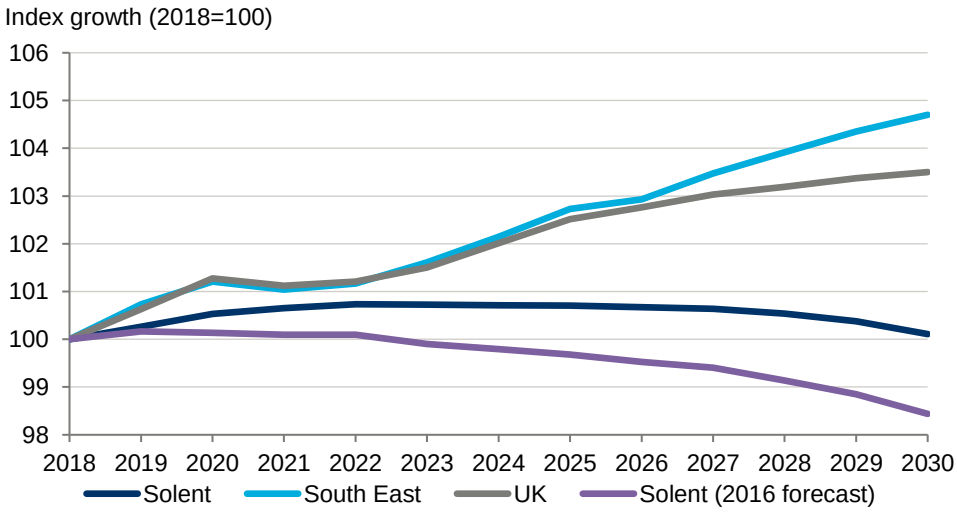
Fig. 22. Population components, Solent local authority areas, 2018-30

	Population, 000s			Working age, 000s		
	2018	2030	%y/y	2018	2030	%y/y
Eastleigh	132	139	0.43%	81	81	0.05%
Fareham	117	121	0.31%	70	70	-0.04%
Gosport	86	90	0.40%	53	51	-0.22%
Havant	126	131	0.36%	74	72	-0.29%
Isle of Wight	142	145	0.17%	80	74	-0.68%
Portsmouth	217	231	0.52%	146	149	0.17%
Southampton	255	277	0.69%	174	183	0.39%
New Forest	181	185	0.18%	100	100	-0.04%
Solent	**1,254**	**1,318**	**0.42%**	**779**	**780**	**0.01%**

Source: Oxford Economics

The working-age component of Solent's population is expected to grow notably slower than the overall total over the next five years. Indeed, we expect working age population levels to contract from 2022. This is a more positive outlook than those in our Winter 2016 forecasts. In contrast, growth in the South East's working-age population is likely to be significantly stronger, averaging 0.38 percent per year over the same period.

Fig. 23. Working age population growth, Solent and comparators, 2018-30

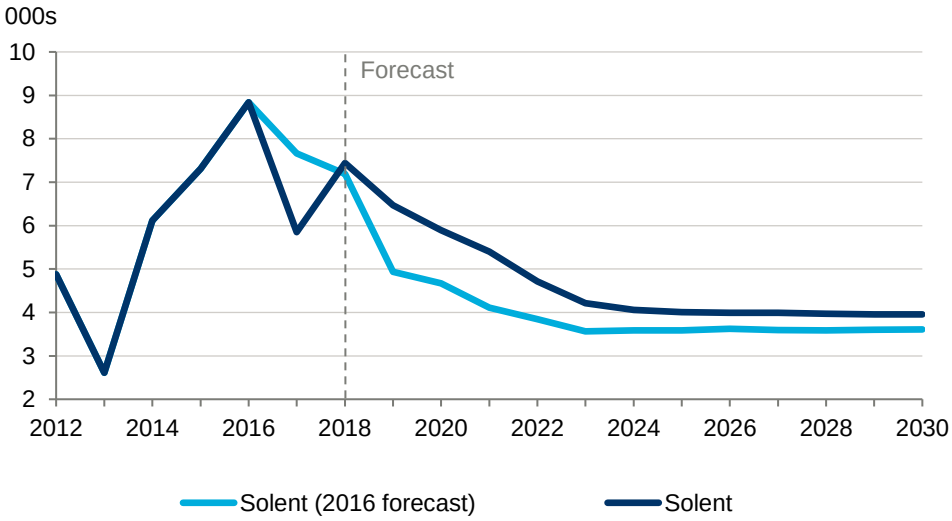


Source: Oxford Economics

While net migration is expected to remain positive (i.e. more people are moving into the Solent LEP than leaving), it will weaken over the forecast period. This is in large part driven by Government ambitions to limit annual net migration to under 100,000 across the UK. We forecast annual net migration to Solent falling to almost half the level it was in 2016 (Fig. 24). The updated migration outlook broadly matches that of our 2016 view in the longer term, however the fall in net migration is now expected to be more gradual in comparison. The

improved working age population growth rate is influenced by the LEP's revised net-migration outlook. Since younger people are on average more likely to migrate than older people, the stronger net migration outlook is likely to boost the working age cohort within the LEP.

Fig. 24. Net migration, Solent, 2012-30

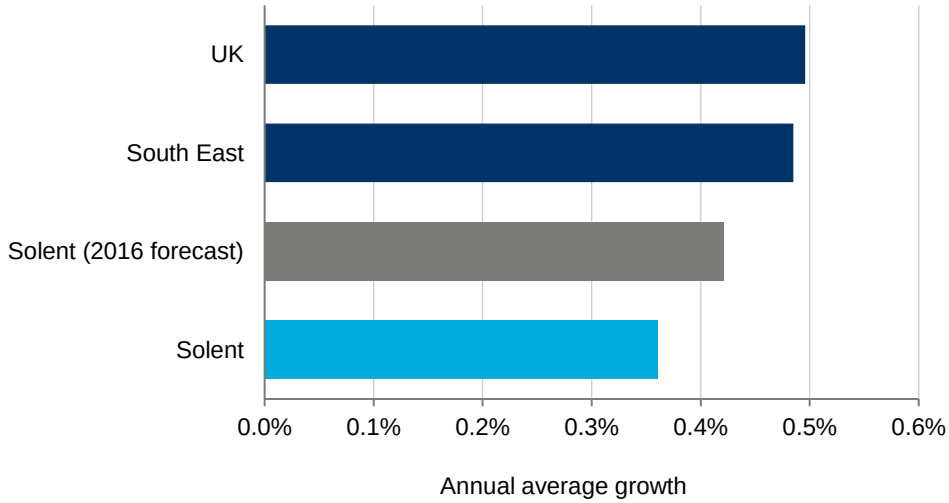


Source: Oxford Economics

4.2 LABOUR MARKET

We expect to see modest employment growth in our baseline outlook, with the Solent economy generating a net additional 26,000 jobs by 2030. But it will underperform the wider South East region in this respect, growing by less than 0.4 percent annually. In contrast, we forecast job growth in the South East to broadly match the national average—both growing by close to 0.5 percent per year to 2030.Furthermore, the LEP's employment outlook has been downgraded since our last update—with job growth now expected to be six basis points (0.06%) weaker over the forecast period. The downgrade of the outlook is mainly attributed to weaker performance in the LEP's wholesale & retail, information & communication and manufacturing sectors. The largest absolute downgrade was within the wholesale and retail sector which is impacted by a weaker consumer spend outlook locally. Furthermore, manufacturing related job loses have been revised up as confidence in the sector continues to weaken.

Fig. 25. Employment, Solent and comparators, 2018-30



Source: Oxford Economics

At a local level, Southampton and Eastleigh are forecast to grow faster than these national and regional averages, averaging 0.7 and 0.6 percent employment growth per annum respectively. However, the LEP's remaining local economies are expected to record relatively disappointing employment growth rates, reflecting both their sectoral structures and their demographics. With working-age populations projected to contract in five of the local authorities, productivity improvements will be the key driver of GVA growth across much of the LEP.

Fig. 26. Employment, Solent's local authority areas, 2018-30

	Workforce jobs (000s)		Change	
	2018	2030	000s	%y/y
Eastleigh	77	82	5.7	0.6%
Fareham	56	58	1.9	0.3%
Gosport	26	26	0.4	0.1%
Havant	52	54	2.1	0.3%
Isle of Wight	60	60	0.7	0.1%
Portsmouth	120	125	4.2	0.3%
Southampton	126	136	10.3	0.7%
New Forest	80	81	1.0	0.1%
Solent	**597**	**624**	**26**	**0.4%**

Source: Oxford Economics

Overall, job growth will continue to be hampered by losses in the LEP's relatively heavy manufacturing and public administration & defence sectors. Together, these sectors will be responsible for over 9,000 net job losses across the economy to 2030.

In absolute terms, the most significant drivers of job growth will be the health and administrative & support sectors, each providing over 6,000 additional jobs by 2030. But in relative terms, the smaller office-based private service sectors, including professional services and information & communications, are generally expected to enjoy the strongest growth potential in the LEP.

Fig. 27. Sectoral employment, Solent, 2018-30

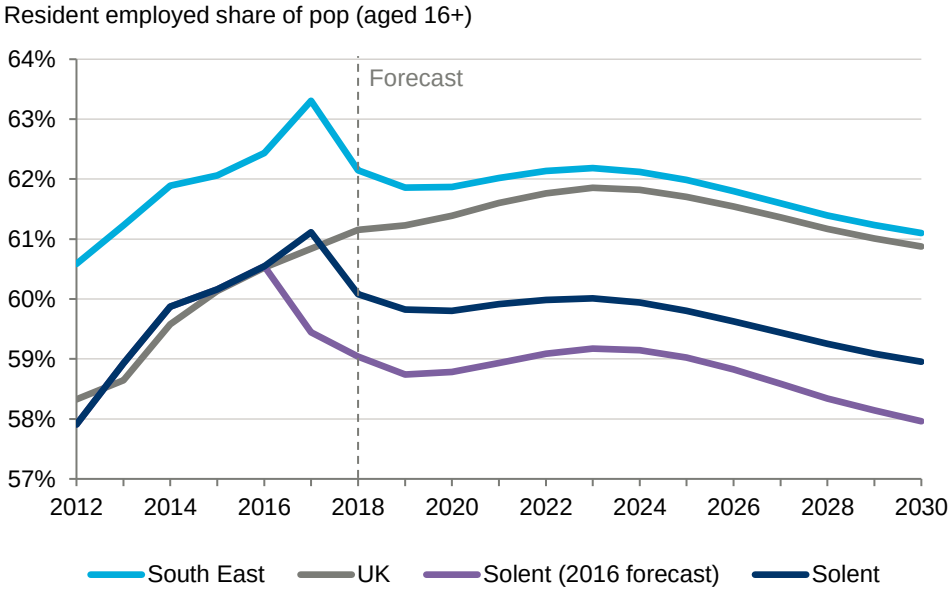
Solent LEP	2018	2030	2018-30	
	000s	000s	Change (000s)	%y/y
Agri, forestry and fishing	4.2	4.0	-0.2	-0.4%
Mining and quarrying	0.5	0.4	-0.2	-3.3%
Manufacturing	41.3	33.6	-7.7	-1.7%
Electricity, gas, steam	2.9	2.5	-0.3	-1.1%
Water supply; sewerage, waste	3.8	3.4	-0.4	-0.9%
Construction	44.0	48.9	4.9	0.9%
Wholesale and retail	84.0	85.6	1.6	0.2%
Transportation and storage	28.9	29.6	0.7	0.2%
Accommodation and food	46.3	48.9	2.7	0.5%
Information and comms	27.4	29.9	2.5	0.7%
Financial and insurance	14.2	14.1	-0.1	0.0%
Real estate	8.5	9.3	0.7	0.7%
Professional, scientific and tech	37.1	42.3	5.2	1.1%
Administrative and support	45.3	51.9	6.6	1.1%
Public admin and defence	34.2	32.8	-1.4	-0.3%
Education	59.7	60.5	0.8	0.1%
Human health	80.1	87.8	7.7	0.8%
Arts, enter. and recreation	18.3	20.8	2.5	1.1%
Other service activities	16.6	17.4	0.8	0.4%
Total	**597**	**624**	**26.3**	**0.4%**

Source: Oxford Economics

The combination of relatively weak workplace employment growth and ageing demographics will weigh on Solent's employment rate for the population aged 16 and over.[9] While employment rates will gradually decline throughout the UK over the next decade, Solent will weaken more notably over the short term, and is forecast to undershoot both the UK and regional averages by close to two percentage points by 2030 (see Fig. 28). Our current forecasts for Solent's resident employment rate are slightly higher than those produced in Winter 2016, however our expectation for future growth are relatively unchanged. The difference is due to better than expected performance in 2017.

[9] Our employment rates methodology measures the share of the population aged 16-and-over in employment. This accounts for older people who are increasingly choosing to remain active within the labour market.

Fig. 28. Employment rate, Solent and comparators, 2012-30



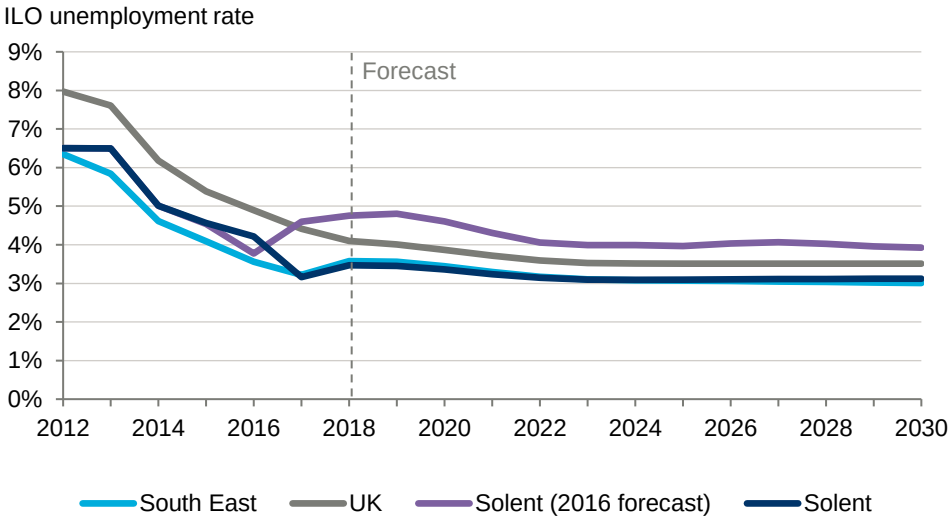
Source: Oxford Economics

Faster than expected job growth across the UK mean unemployment rates are now lower in 2018 than we had forecast in Winter 2016. This is due to the continued reluctance of the private sector to investment amidst Brexit uncertainty, the resulting slow down in productivity growth and the need to meet additional demand through additional employment.

Looking forward, job growth, though relatively weak, will outpace that of the working-age population, thereby keeping Solent's unemployment rate close to its historically low level—although still marginally above the South East region's average over the forecast period.

As identified earlier, while inactivity rates have been falling recently in Solent, the relative size of this group remains above that of the regional average. These people therefore represent a pool of labour that could be used to fill future job creation, if they could be attracted back into the labour market.

Fig. 29. Unemployment, Solent and comparators, 2012-30



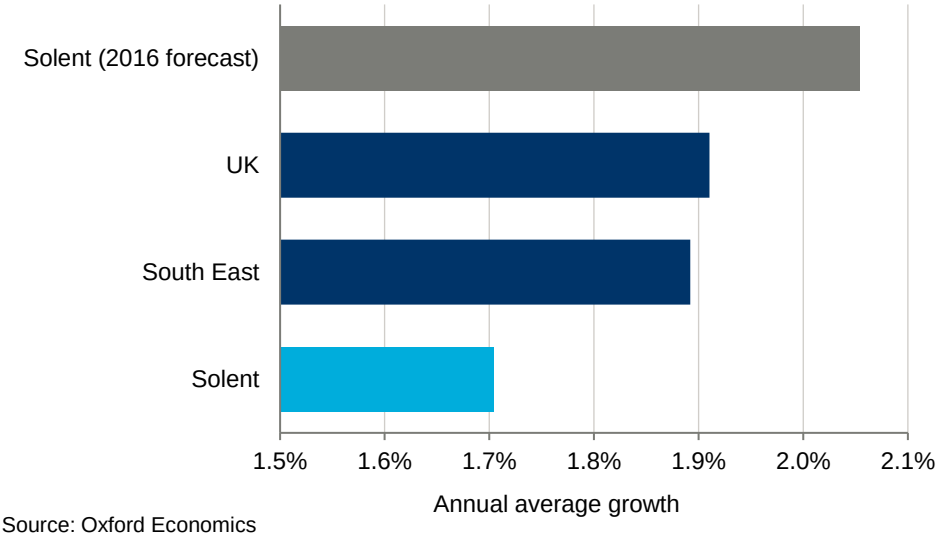
Source: Oxford Economics

4.3 ECONOMIC OUTPUT

Solent's GVA total will reach almost £37.4 billion (in 2016 prices) by 2030. Growth will be significantly stronger than that experienced in recent years, with the economy expanding by an annual average of almost 1.7 percent over the 12-year outlook. Solent's GVA growth continues to trail both the South East and national averages over the forecast—albeit to a lesser extent than in recent years. In comparison, both the regional and national economies are set to grow by an average of 1.9 percent per year over the same period, meaning that Solent's annual GVA share of the South East economy will fall marginally by 2030.

The UK's GVA growth outlook has weakened since the 2016 outlook—falling from 2.2 percent each year on average between 2018 and 2030 to 1.9 percent in the current outlook. Equally, Solent's growth outlook to 2030 has weakened from 2.1 percent to 1.7 percent. A breakdown of the contributing factors show that much of this weakening is due to downgraded productivity growth over the forecast period.

Fig. 30. GVA, Solent and comparators, 2018-30



Source: Oxford Economics

We forecast Eastleigh to enjoy the fastest rates of GVA growth at 2.0 percent per annum, followed closely by Southampton at 1.9 percent. Despite disappointing employment forecasts in most local areas, average annual GVA growth is forecast to be a minimum of 1.4 percent over the period (in the New Forest local authority), reflecting improvements in productivity growth.

Fig. 31. GVA, Solent's local authority areas, 2018-30

	GVA (£2016m)		Change	
	2018	2030	£2016m	%y/y
Eastleigh	4,284	5,423	1,139	2.0%
Fareham	2,782	3,370	589	1.6%
Gosport	956	1,138	182	1.5%
Havant	2,771	3,407	636	1.7%
Isle of Wight	2,840	3,377	537	1.5%
Portsmouth	5,697	6,946	1,249	1.7%
Southampton	6,990	8,743	1,753	1.9%
New Forest	4,251	5,039	789	1.4%
Solent	**30,571**	**37,444**	**6,873**	**1.7%**

Source: Oxford Economics

Economic growth is driven by changes in the productive capacity of the economy, either through changing workforce levels or improvements in productivity levels (output per worker). As previously stated, productivity growth is set to be the dominant driver of economic growth across Solent over the outlook. The LEP's average productivity level is forecast to grow on average by 1.3 percent each year, a rate only slightly weaker than that expected across both the UK and South East. The productivity level is therefore likely to reach £60,000 per job by 2030—still nearly 10 percent weaker than the average /across the South East region.

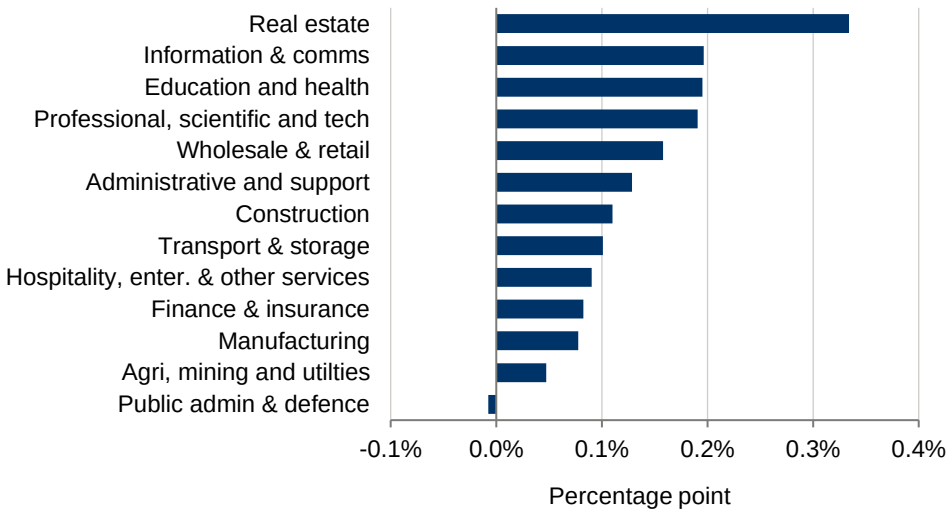
Fig. 32. Constituent GVA growth factors, Solent and comparators, 2018-30

	Annual average growth (y/y)		
	Employment	Productivity	GVA
Solent	0.4%	1.3%	**1.7%**
South East	0.5%	1.4%	**1.9%**
UK	0.5%	1.4%	**1.9%**

Source: Oxford Economics

The real estate sector is set to be the dominant contributor to GVA growth across the LEP, growing by £1.2 billion to 2030. The professional services and information & communications sectors represent other key growth sources—accounting for nearly a quarter of all local GVA growth, despite constituting less than 10 percent of Solent's economy in 2018. In the manufacturing sector, continued productivity gains will boost output growth despite further falls in its employment level.

Fig. 33. Sectoral contribution to GVA growth, Solent, 2018-30



Source: Oxford Economics

The combination of these factors suggests that Solent's productivity gap with the wider region is likely to be maintained through to 2030. Furthermore, the LEP's previously enjoyed productivity advantage over the UK as a whole is likely to remain elusive, with average productivity levels across Solent expected to broadly match that of the UK over the outlook.

4.4 SUMMARY

Population growth in Solent will underperform that of the South East over the outlook. Much of this weakness will be driven by the LEP's working-age component, which is expected to experience very little change by 2030.

Job growth is set to continue to underperform the regional average, with net gains hampered by losses in the LEP's relatively heavy manufacturing and

public administration sectors. These combined factors will likely contribute to a falling employment rate across the LEP.

Solent's economy is therefore expected to grow at a slightly slower pace than the regional economy over the outlook, with productivity gains becoming the most prominent driver. However, the LEP's improving productivity levels are unlikely to be strong enough to close the current growth gap to the wider South East region.

Population growth to 2030 will be strongest within Southampton and Portsmouth. Growth in Solent's remaining council areas will be weaker, due to contractions (or negligible growth) within the working-age populations of these areas.

The strongest job growth is expected to take place within Southampton and Eastleigh, the only two local economies in Solent that are expected to outperform the South East region over the forecast. Linked to this, both areas will enjoy the strongest GVA growth within Solent, with Eastleigh's growth set to outperform both the regional and national averages.

5. BREXIT-RELATED RISKS

5.1 BREXIT ASSUMPTIONS

The long shadow of Brexit continues to hover over the UK, with all its associated risks and uncertainties, and forms a key component of both the Q1 2019 forecasts—which underpin the analysis in sections 2 to 4—and our current view at the time of writing this (early November 2019). Over the following pages we present a comparison of the Q1 2019 and Q3 2019 outlooks for the UK economy.

The working assumption in the first quarter of 2019 was that the original withdrawal agreement ('May's deal') would eventually be passed, enabling the UK to leave the EU on the original date of 29th March—remaining in the bloc's single market (and bound by its rules) until the end of December 2020, while the two sides agree a new trading relationship.

However, this did not come to pass, and the UK subsequently requested (and the EU accepted) an extension to the deadline, to 31st October. A change of government led to a reworking of the withdrawal agreement, altering the contentious Northern Irish 'backstop'[10] in the original deal to a more permanent customs arrangement, which effectively imposes a regulatory and customs border between Great Britain and Northern Ireland.

Changes to the accompanying political declaration also aim to conclude a basic free trade agreement, rather than the closer relationship envisaged in the previous iteration, reflecting the UK government's desire to operate a fully independent trade policy. The more distant relationship between Great Britain and the EU, implied by the reworked deal, would see firms face higher non-tariff barriers to trade—reflecting a more damaging prospect for long-term growth than May's deal.

However, a failure for this Bill to proceed through Parliament on the Government's preferred timetable ahead of the end of October deadline—and attempts by Parliament to block a 'no deal' outcome (through the 'Benn' Act)—has led to the EU granting a further extension to 31st January 2020, with the option to leave earlier, should the UK complete the ratification process ahead of this date.

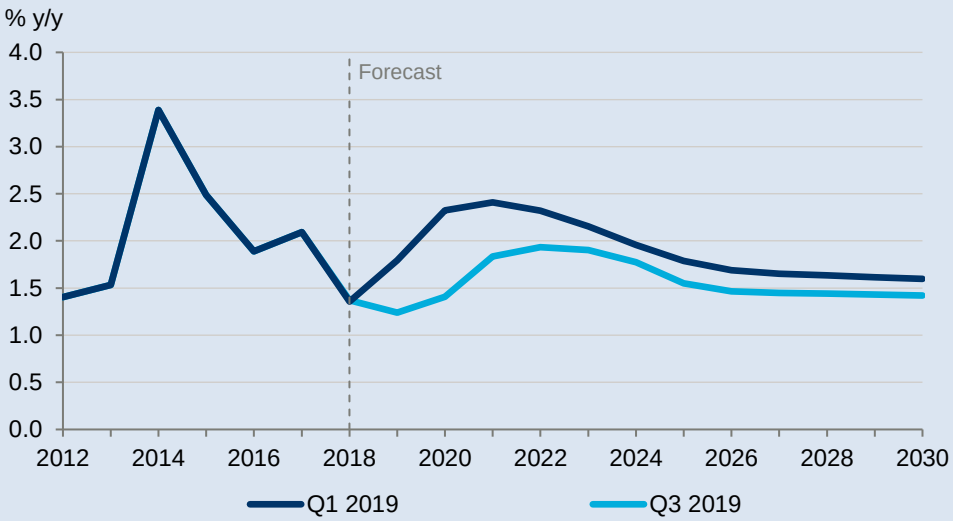
Parliament has subsequently agreed a General Election to take place in mid-December. Our current assumption remains that the UK will formally leave the EU in early 2020.

[10] An insurance policy that means, in the absence of a trade agreement by the end of the original transition period, the UK will either further extend the transition period, or go into a customs arrangement covering the whole of the UK (a position from which the UK could then unilaterally exit).

CHANGES TO THE UK ECONOMIC OUTLOOK

A comparison between our Q1 2019 and Q3 2019 forecasts, the latest at the time of writing (November 2019), shows a downgrade to the outlook for the UK economy. The economy is expected to grow by 1.2% in 2019, below the 1.8% estimated in Q1 2019, reflecting continued uncertainty over Brexit and weaker global growth. Growth will remain below the Q1 2019 forecast thereafter and is not expected to exceed 2.0% in any given year, lagging the previous forecast by around 0.2 percentage points each year through the late 2020s. Over the period 2019-30, the UK economy will grow by an average of 1.6% per year, 0.3 percentage points below the equivalent rate in Q1 2019 (1.9% per year).

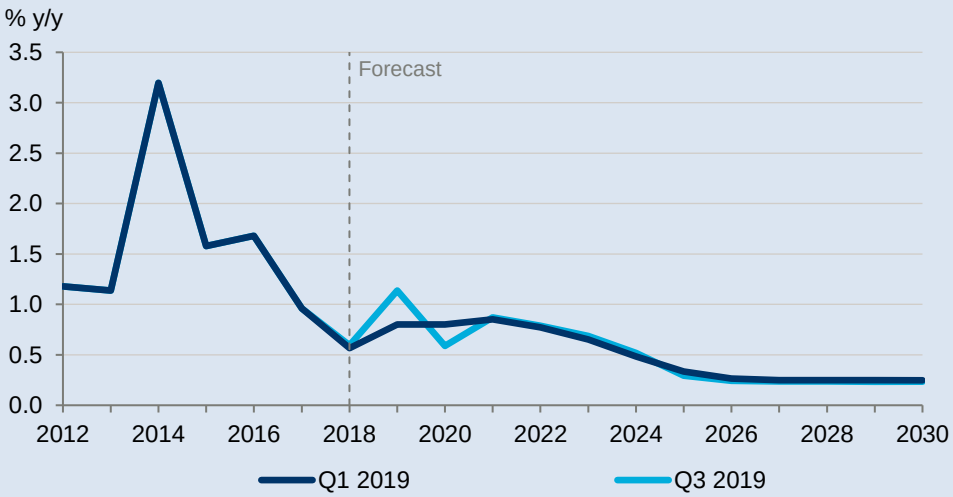
Fig. 34. Real GVA growth, UK 2012-2030



Source: Oxford Economics

The outlook for employment however will remain broadly unchanged. Despite some short-term discrepancies between the Q1 2019 and Q3 2019 forecasts, employment growth in both sets of forecasts is expected to converge to 0.2% per year towards the end of the 2020s.

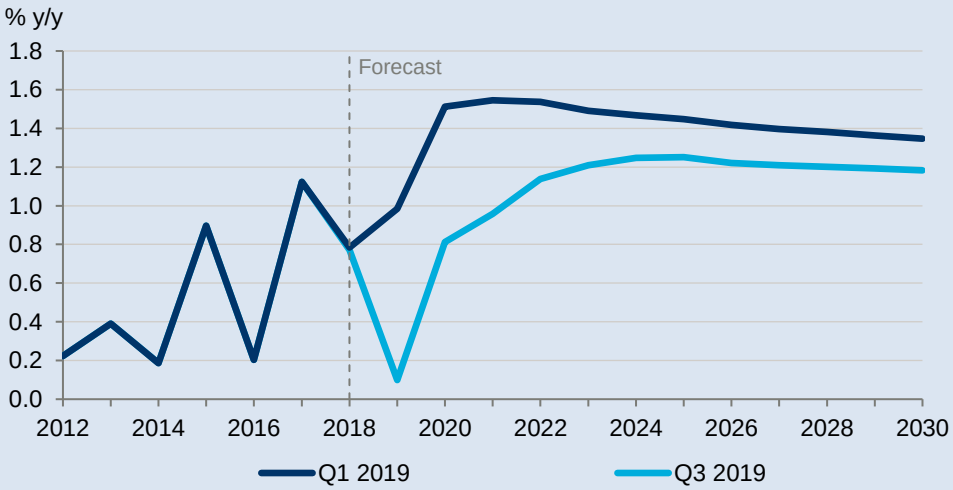
Fig. 35. Employment growth, UK 2012-2030



Source: Oxford Economics

This implies a weaker outlook for productivity. Indeed, largely as a result of weaker recent data following the Q1 2019 forecast, we estimate that productivity will grow by just 0.1% in 2019, compared to 1.0% in the previous forecast. While the profile of productivity growth will be broadly similar—rising in the short term, before slowing slightly thereafter—it will grow at a slower rate in each year. Across the period 2019-30, productivity will grow by 1.6% per year on average, 0.3 percentage points slower than in the Q1 2019 forecast (1.9%). By 2030, UK productivity will be £58,300 (in 2016 prices), 4.1% (or £2,500) lower than in the Q1 2019 forecast.

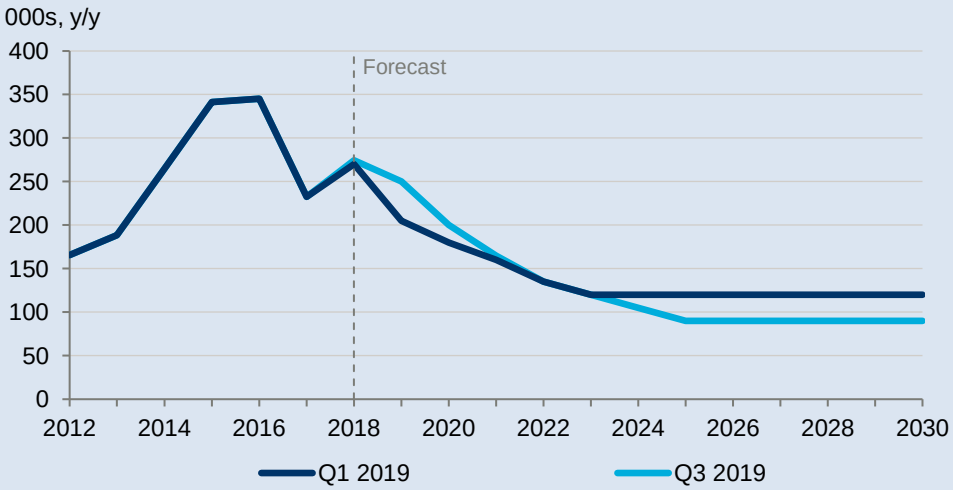
Fig. 36. Productivity growth, UK 2012-2030



Source: Oxford Economics

The other main difference between the two forecasts relates to the population. Subsequent to the Q1 2019 forecast, we have also downgraded our assumptions for net migration: in the long-run we now assume an annual flow positive net flow of 90,000 migrants to the UK each year, compared to 120,000 in the Q1 2019 forecast. In aggregate, this will reduce UK population in 2030 by 181,900.

Fig. 37. Annual net migration, UK 2012-2030



Source: Oxford Economics

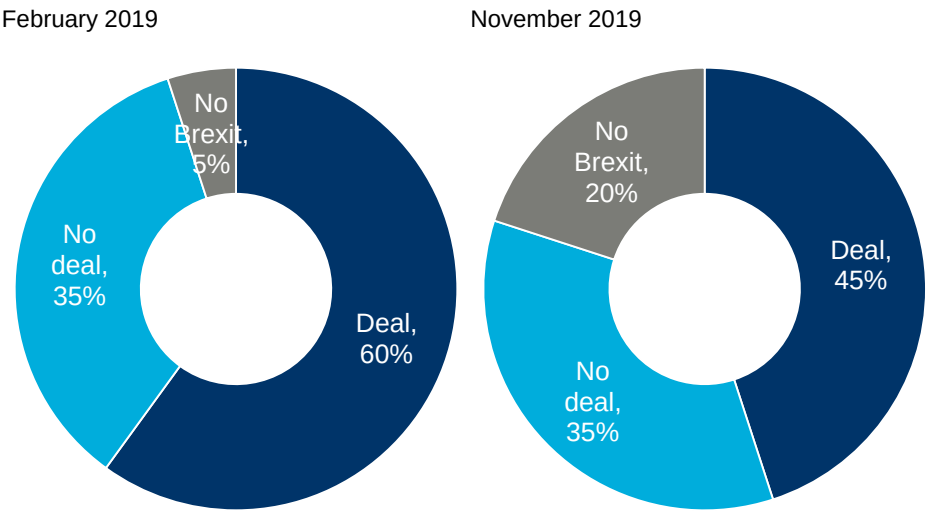
5.2 RISKS OF A NO DEAL BREXIT

The current deal allows Britain to leave the EU but to remain inside the bloc's single market (and bound by its rules) until the end of December 2020, while the two sides work on a new trade relationship. Even were the deal to pass before the 31st January 2020 deadline, risks of the UK crashing out in a 'no deal' outcome remain high.

The probabilities associated with each Brexit outcome have also changed over time. Our assessment in February—which formed the basis for our Q1 2019 forecasts—placed a 60% probability on the deal passing, a further 35% likelihood of a no deal outcome, while the chances of either a second referendum (with a Remain victory) or a revocation of Article 50 were at just 5%.

Our current view is that the probability of the latter has risen. Our October outlook (the basis for our Q3 2019 forecasts) place a one-in-five chance of a no Brexit outcome. The increased likelihood of no Brexit comes at the cost of the likelihood of passing the deal, which our analysis places at just 45%. Our assessment of the likelihood of no deal has not changed, and at 35% remains a significant downside risk to our baseline forecast.

Fig. 38. Brexit outcomes by probability, February and October 2019



Source: Oxford Economics

5.3 IMPLICATIONS OF NO DEAL

The current stalemate means a 'no deal' outcome remains a distinct possibility. There are several UK-wide consequences associated with such a scenario:

1. **Additional trade frictions**: tariffs are imposed on UK-EU trade, and also on UK trade with other countries with whom the EU has Free Trade Agreements (FTAs), in addition to non-tariff barriers being erected. Any subsequent delays at the ports will be felt most keenly in industries that relay on 'just-in-time' supply chain deliveries, such as the car manufacturing and supermarket sectors.

2. **Initial sharp drop in asset prices**: with a likely drop in both sterling and, to a lesser degree, the euro.
3. **Looser monetary policy**: central bank of England is likely to cut interest rates in order to boost demand.
4. **Looser fiscal policy**: the UK government is also likely to divert funds earmarked for the EU 'divorce bill' into higher government consumption, with higher borrowing to fund spending tolerated in the short-term.

If the two sides fail to finalise the withdrawal agreement and the UK leaves the EU in a disorderly fashion in January 2020, this is likely to lead to a significant slowdown in the UK economy. While these impacts can be mitigated to a degree by looser monetary and fiscal policy (as expressed in points 3 and 4 above), we would still expect the UK's GDP level at the end of 2020 to be close to two percent lower than in our baseline forecast.

But what would 'no deal' mean for Solent specifically? Would the LEP be overly exposed to the risks associated with this outcome?[11]

Under its new boundary, Solent retains a relatively large manufacturing base and a strong marine tradition. Indeed, comparing Solent's revised boundary sectoral employment shares to that of GB overall, shows that water-based transport and several more high-tech manufacturing sub-sectors all remain prominent locally.[12]

Some of Solent's manufacturing sub-sectors (such as optics and medical instruments) have a relatively low reliance on the EU market for demand. Others, such as the aircraft manufacturing sector, are more vulnerable to changes in demand from the EU—with some products likely to be destined for the likes of Airbus, an operator that has already announced the possibility of leaving the UK in the event of 'no deal'.

The maritime sector is likely to be protected (to a degree) by the relatively price-insensitive nature of the high-end, small vessel market. Nonetheless, water-based passenger and freight transport activity could be hampered by 'no deal' disruption, at least until both sides agree reciprocal measures—even in the short term.

Collectively, the ports at Southampton and Portsmouth account for over 38 million tons of cargo volume each year—12 percent of England's total in 2017. The Southampton port facilitates most of this traffic (34 million tons), although is relatively underexposed to the EU—with almost a quarter of its freight traffic involving EU routes in 2017, compared to almost 50 percent in most other major English ports. Portsmouth, however, has a very important trade in fresh produce from Spain, which appears extremely vulnerable to a particularly hard Brexit.

Lastly, in the absence of a new, post-Brexit, migration policy with the EU, a 'no deal' scenario could significantly impact EU worker migration flows. Migration Observatory analysis of the 2015 Labour Force Survey looked at the

[11] See Oxford Economics' Solent October 2016 report, 'Baseline forecasts and the implications of Brexit', for the original analysis.

[12] Using location quotient analysis—a way of quantifying how concentrated a industry, cluster, occupation is locally compared to the larger economic geography.

employment of EU nationals as a share of all workers in each industry. It showed that 13 percent of workers in the accommodation & food services sector were born in EU countries—roughly double the average across all UK industries (6.6 percent). Equally, manufacturing recorded an above-average representation of EU workers, at 10 percent of the total workforce. Both these sectors are prominent employers within Solent but are exposed in slightly different ways.

As laid out in section 4.2, we expect the accommodation & food sector to expand over the next decade, creating demand for additional workers—typically lower-skilled. Manufacturing, on the other hand, is set to contract in jobs terms—but while this sector will require less people, the average skill level needed will most likely rise. Therefore, in both sectors, skill shortage pressures could worsen following a 'no deal' outcome.

5.4 BUSINESS PERSPECTIVES

The risks within our 'no deal' scenario are heavily skewed to the downside—meaning, a failure to comprehensively establish the necessary customs infrastructure in time could easily generate a worse outcome. Within this context, businesses are particularly vulnerable given the lack of clarity regarding the future trading arrangements with the EU. In the event of a 'no deal' the UK may be able to strike some short-term arrangements in high priority areas, such as air travel (to ensure its aircraft are able to fly not just to EU destinations but to the rest of the world, given the UK's current deals are by virtue of its membership of the EU). However, it is the most highly regulated sectors, such as food & beverages, chemicals and financial services, which are most at risk of substantial barriers to trade going up upon the UK's exit without a deal. In the case of financial services, it is likely that UK firms will no longer have 'passporting' rights and would need to meet an equivalency standard test in order to be able to conduct activity in the EU.

Recent Brexit briefings by the CBI have highlighted the diverse range of potential barriers that UK goods export businesses could face in the absence of a deal.[13] Some of these potentially disruptive influences are summarised below from the perspective of different industry groups:

Market access risks: A UK based independent cosmetics business currently sells its products to the EU. The packaging of all cosmetics products sold in the EU must display the address of the company that produced it. However, this address must be in the EU and it must be a staffed office. In the absence of a deal between the UK and the EU the company must decide if the costs associated with a new office is justifiable to gain access to the EU market. If not, they may be forced to stop exporting to the EU, or to sell their intellectual property rights for their products to larger companies with existing European offices.

Increased cost base: Currently, a UK technology firm can ship the specialist products it makes in the EU directly to its customers in the UK. However, the goods it produces outside the EU must first be shipped to a UK site where the necessary VAT paperwork is processed in accordance with all products

[13] CBI, '*What happens if there's no deal?*', Brexit Policy Briefing, 2017

produced in non-EU countries. In absence of a deal between the UK and the EU, this additional administrative burden would then accompany all EU products. Therefore, potential large quantities of packages would have to first be processed through the business' UK-based sites before reaching the end consumer. Under this scenario the company would likely need additional warehousing capacity, alongside the extra staff and machinery required. Both costs and estimated order times would increase as a result.

Supply chain concerns: A UK based manufacturer supplies components which make up 25 percent of a final product, which is to be assembled in South Korea. Manufacturers in Mexico, Poland and South Korea also individually produce 25 percent each. Currently, South Korea and the EU have a trade agreement which stipulates that a final product can be sold tariff-free if at least 60 percent of the product's inputs come from either the EU or South Korea.

However, in the absence of deal, only 50 percent of the of the final product will be counted as 'local product' and therefore the final product can no longer be sold tariff-free. Given such disincentives, a UK firm would be justifiably concerned that they could be excluded from such supply chain procurement contracts in the future.

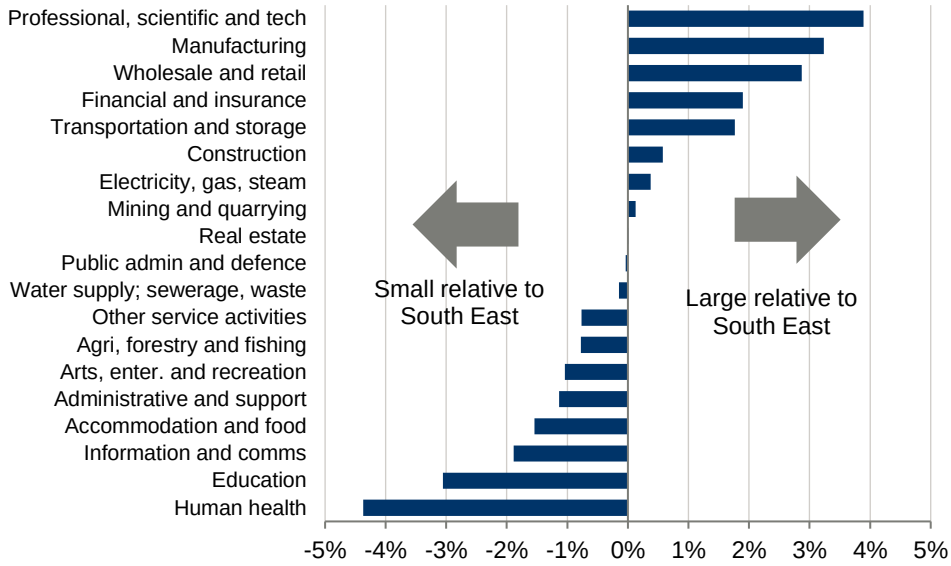
5.5 SUMMARY

While there continues to be a great degree of uncertainty regarding Brexit, we believe that the most likely outcome will be that Britain leaves the EU in early-2020. However, the risks of a 'no deal' outcome remains a significant possibility.

A disorderly withdrawal from the EU would likely lead to a significant slowdown across the UK economy. However, certain local economies will be more exposed than others, based on their own unique characteristics. Within Solent, this picture is mixed. Solent's maritime related strengths should provide some protection with more limited exposure to EU demand. However, manufacturing clusters are more exposed to potential trade barriers and skill shortage pressures are a vulnerability across the economy.

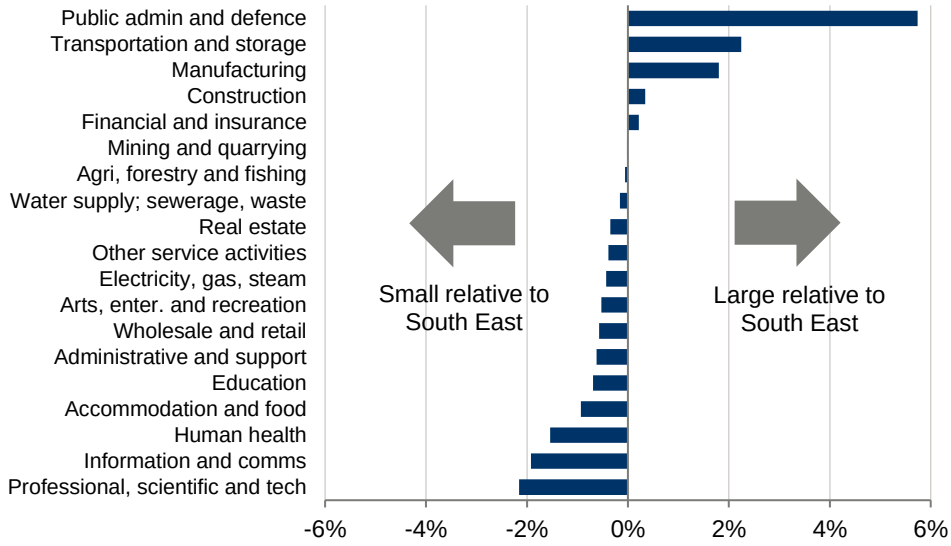
TECHNICAL APPENDIX

Fig. 39. Sectoral employment structure, Eastleigh vs South East, 2018



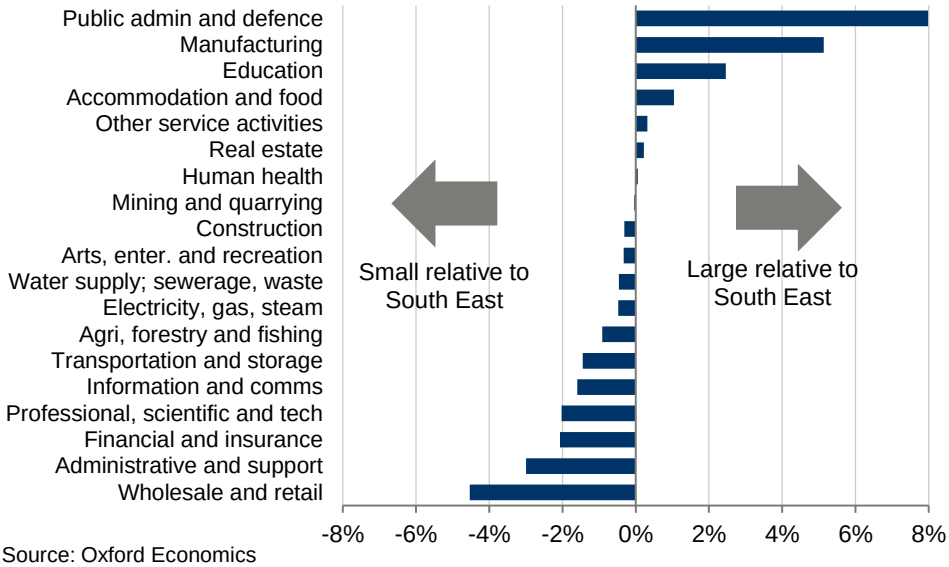
Source: Oxford Economics

Fig. 40. Sectoral employment structure, Fareham vs South East, 2018



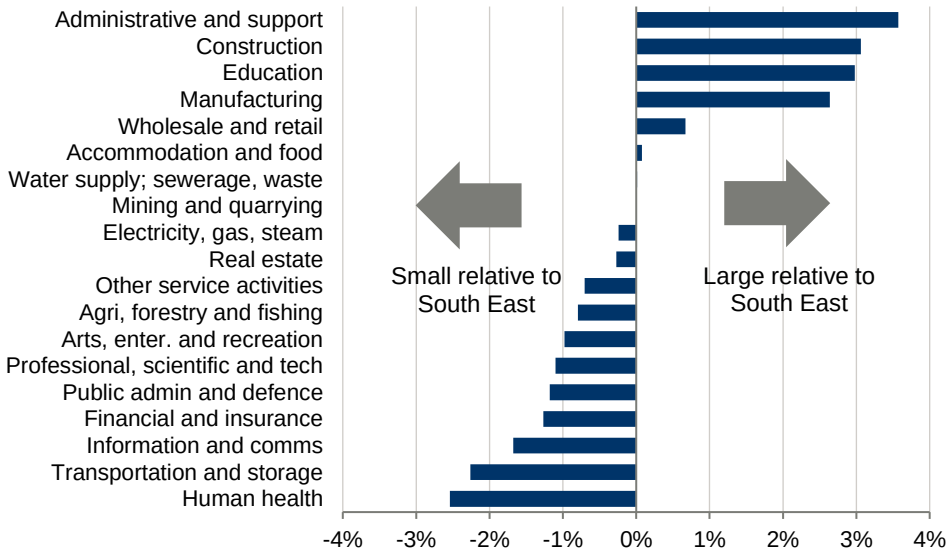
Source: Oxford Economics

Fig. 41. Sectoral employment structure, Gosport vs South East, 2018



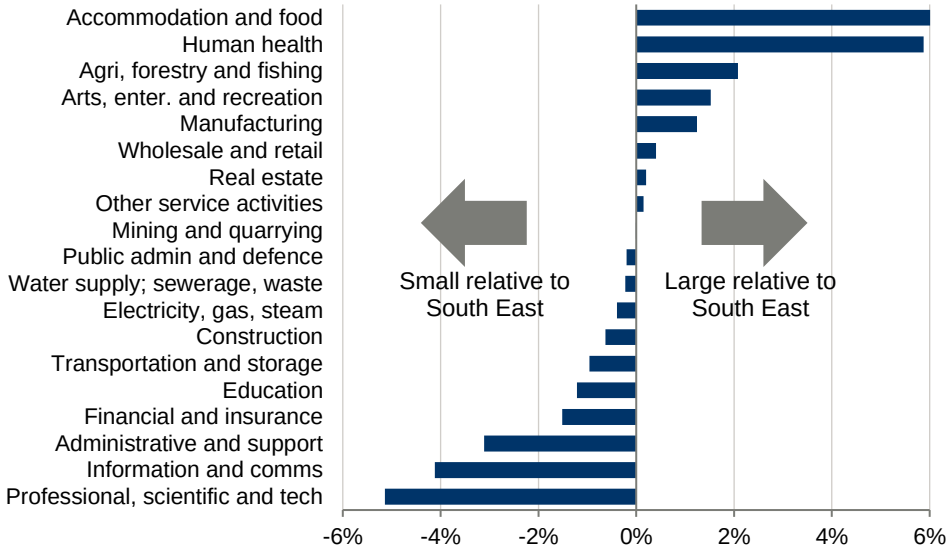
Source: Oxford Economics

Fig. 42. Sectoral employment structure, Havant vs South East, 2018



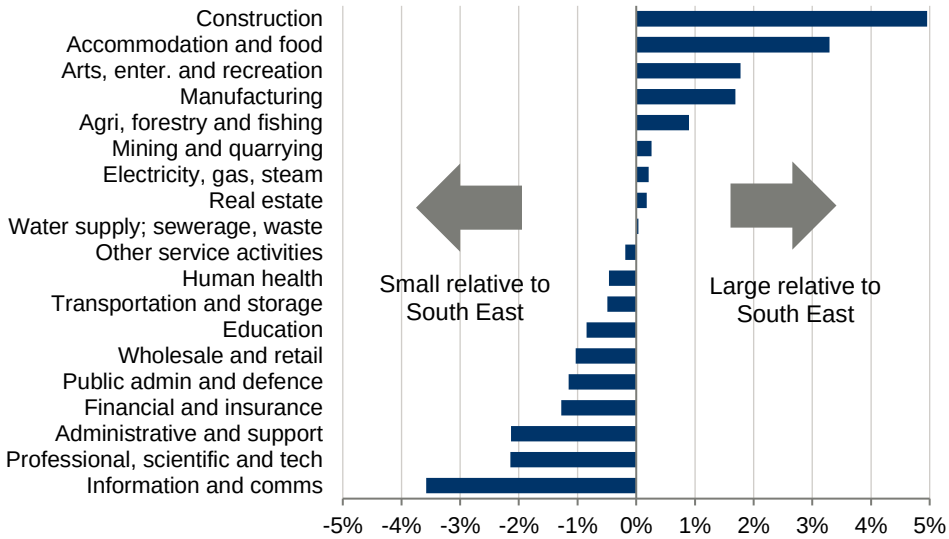
Source: Oxford Economics

Fig. 43. Sectoral employment structure, Isle of Wight vs South East, 2018



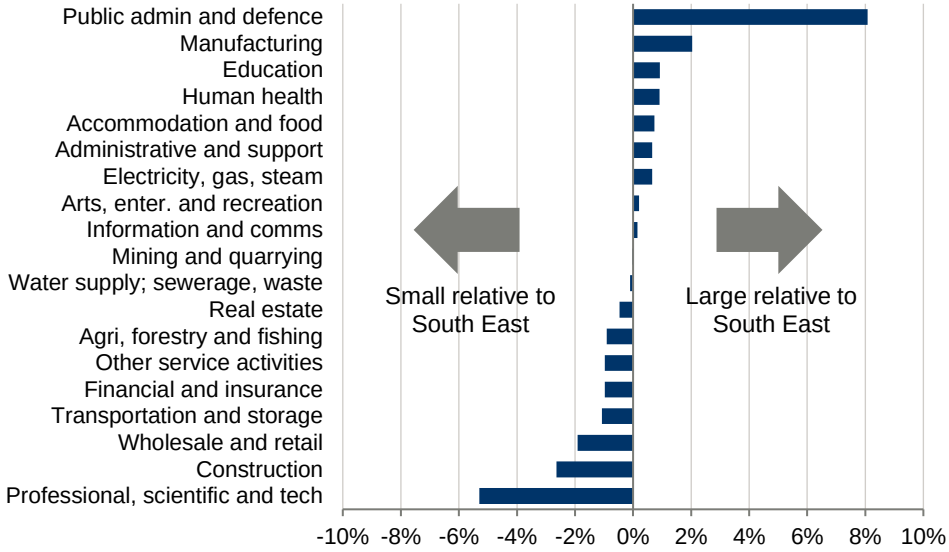
Source: Oxford Economics

Fig. 44. Sectoral employment structure, New Forest vs South East, 2018



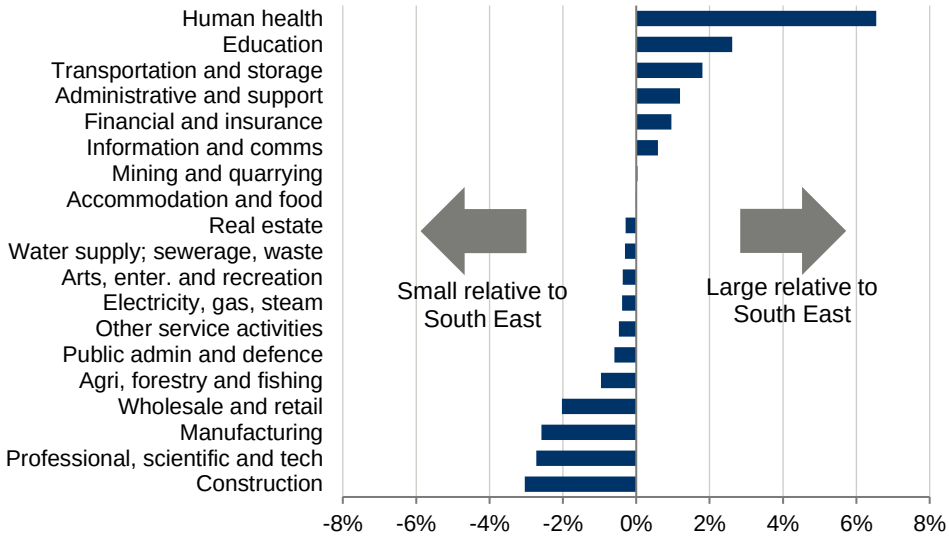
Source: Oxford Economics

Fig. 45. Sectoral employment structure, Portsmouth vs South East, 2018



Source: Oxford Economics

Fig. 46. Sectoral employment structure, Southampton vs South East, 2018



Source: Oxford Economics

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