Economic Outlook

Government commitment in uncertain times

Autumn Statement – November 2016

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Planning. Design. Economics.

With economic uncertainty looming, the Chancellor has engineered some flexibility in the public finances to invest more in housing and infrastructure and boost productivity

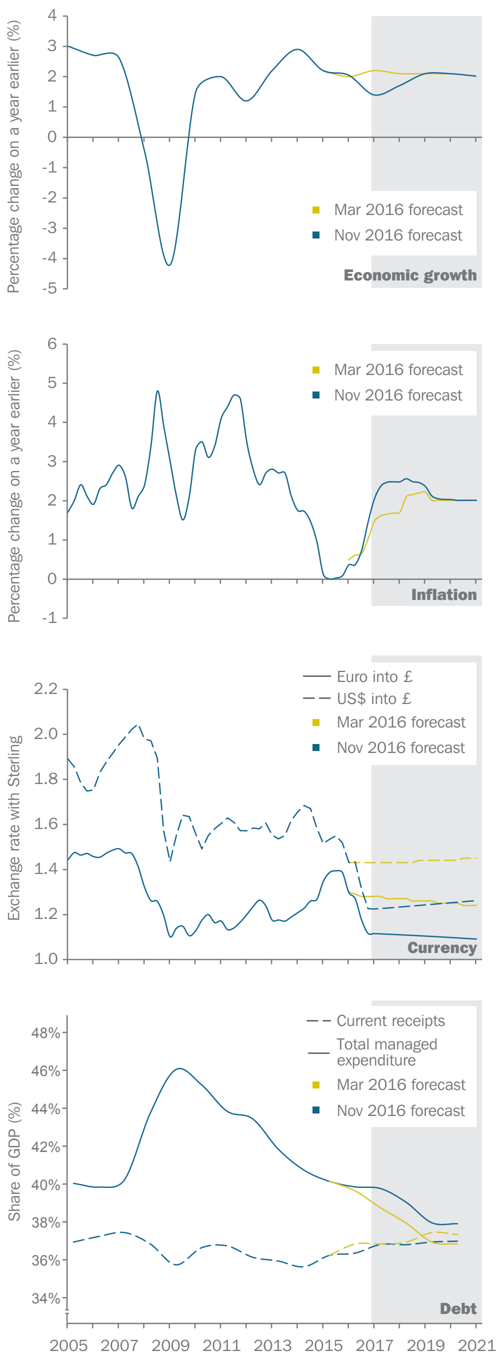
In his first major budgetary speech of his tenure, the Chancellor, Philip Hammond, has relaxed his predecessor's deficit constraint allowing for greater public investment. In moving back the goal for achieving a budget surplus from 2020 to 'as soon as possible in the next term', the Chancellor has committed additional spending to: affordable housing – £1.4bn to build 40,000 new homes; transport infrastructure – £1.3bn with an emphasis on roads; and infrastructure to unlock housing – £2.3bn Housing Infrastructure Fund unlocking up to 100,000 new homes in the areas of high demand. The rationale for this change is down to the Brexit-based uncertainty and long term productivity challenges – the hope is that investing in the economic fundamentals will stimulate growth and provide a positive signal to the markets.

The markets are already pricing in some of that economic uncertainty. As the Office for Budget Responsibility (OBR) sets out, economic growth over the next few years is forecast to be lower than the forecast in March; the pound weaker against the US dollar and euro; and higher inflation (Figure 1). The uncertainty that surrounds the Brexit negotiations has raised many concerns regarding new tariffs and the freedom of movement of people, goods and capital. Further, as the pound weakens, imports become more expensive which can be beneficial for UK exporters, but only if they don't need to import large quantities of materials.

For key macroeconomic indicators, the near future looks mixed. According to the OBR, Gross Domestic Product (GDP) is set to grow by 2.1% in 2016, 1.4% in 2017, 1.7% in 2018 and 2.1% in 2019 and 2020 – with 2016 to 2018 lower than previous forecasts. However, employment is set to rise from 31.7m in 2016 to 32.2m in 2020 and average earnings look set to rise from an annual increase of 2.2% to 3.6% over the same period.

Key policy announcements were made in a range of areas to support economic growth: these are set out on page two. As transport infrastructure plays a central role in the Autumn Statement, page three explores the UK's investment record over the last three decades while page four highlights the unequal distribution of transport investment across the UK.

Figure 1 : Macroeconomic indicators



Source: OBR; NLP analysis

Headline Figures

1.4%	Forecast GDP growth in 2017 (down from 2.2% forecast in March 2016)
90.2%	Public sector net debt as proportion of GDP in 2017 (up from 81.3% forecast in March 2016)
5%	Forecast increase in housing transactions in 2020 compared to 2016
500,000	Increase in employment between 2016 and 2020
£23bn	National Productivity Investment Fund (NPIF) to invest in infrastructure and boost productivity
£2.3bn	Housing Infrastructure Fund to invest in infrastructure and unlock homes (part of NPIF)
£1.3bn	Transport infrastructure funding (focus on road)

Summary of Key Announcements

Targeted housing funds

The Autumn Statement's 'centrepiece', the new £23bn National Productivity Investment Fund (NPIF), targets housing as being one of four critical areas for productivity. Almost one third (£7.2bn) of the Fund will be spent on building new homes, while the rest will support and enhance transport infrastructure, digital communications, and research and development. Of this £7.2bn, a new Housing Infrastructure Fund (£2.3bn) will be allocated to councils to provide infrastructure for unlocking new private house building in areas where housing need is greatest (providing up to 100,000 new homes).

The Autumn Statement also confirms that a Housing White Paper will be published 'shortly', setting out a comprehensive reform package to boost housing supply and halt the decline in housing affordability. It will include planning regime changes: modified details of what starter homes will be; more on the office to residential 'like-for-like' rebuild permitted development right; new guidance on streamlining assessing housing needs and requirements in local plan-making; and fundamental changes to the community infrastructure levy.

Incremental transport improvements over infrastructure revolution

A proportion of the new £23bn NPIF will target the UK's transport networks and infrastructure. £2.6bn committed to transport investment to 2020-21 will mainly address:

- Roads and local transport (£1.1bn), to relieve congestion and upgrade local roads and public transport networks;
- Future transport (£390m), to support the development of ultra-low emission vehicles, renewable fuels, and 'connected and autonomous vehicles';
- Rail capacity and smart ticketing (£450m), to trial digital signalling technology to expand capacity and improve reliability; and
- The Cambridge-Milton Keynes-Oxford corridor, following the National Infrastructure Commission's (NIC) interim recommendations, funds will be available to develop an Oxford-Cambridge expressway (£27m), accelerate construction of the East-West Rail line western section (£100m), and develop funding for the central rail section (£10m).

London, devolution and regional cities

Confirming that London is one of the highest-productivity cities in the world, the Government recognises that economic growth has been concentrated for too long in London and the south east. Although London will receive £3.15bn in affordable housing funding to deliver over 90,000 homes, various measures are confirmed for driving up the performance of regional cities:

- A new strategy for the Northern Powerhouse has been published, alongside a major roads programme and work continuing with Transport for the North on options for Northern Powerhouse Rail;
- Funding (£5m) for the evaluation study for the Midlands Rail hub – the Midlands Engine strategy will follow 'shortly'; and
- A total of £1.8bn from the Local Growth Fund will be allocated to the local enterprise partnerships (LEPs) in England – the breakdown of allocations to individual LEPs will be announced 'shortly'.

The Chancellor has recommitted to city deals with Swansea, Edinburgh, North Wales and the Tay Cities; negotiations are beginning on one for Stirling.

Other infrastructure – 5G Broadband, the NIC, and the new Infrastructure and Projects Authority

The Chancellor has announced over £1bn support (£740m through the NPIF) for the development of full-fibre connections and future 5G communications – to also be delivered through:

- A new Digital Infrastructure Investment Fund (£400m); and
- 100% business rates relief for new full-fibre infrastructure for 5 years from 1 April 2017.

At Budget 2016, 5G-deployment was one of the areas the NIC was appointed to report on, together with the Cambridge-Milton Keynes-Oxford corridor. The NIC has now been asked to undertake a new study on how emerging technologies can improve infrastructure productivity.

Finally, the Chancellor has announced the establishment of the Infrastructure and Projects Authority, a new ministerial group that will review the ways Government, together with industry, can improve the quality, cost and performance of UK infrastructure. The review will first report in summer 2017.

"We choose in this Autumn Statement to prioritise additional high-value investment, specifically in infrastructure and innovation, that will directly contribute to raising Britain's productivity."

Chancellor, Philip Hammond
November 2016

"The challenge of delivering the housing we so desperately need in the places where it is currently least affordable is not a new one… But the effect of unaffordable housing on our nation's productivity makes it an urgent one."

Chancellor, Philip Hammond
November 2016

Transport investment as an economic stimulus

In his first Autumn Statement the Chancellor announced that the Government will forgo the target of achieving a fiscal surplus by 2020 set by his predecessor, providing fiscal flexibility to invest £1.3bn in transport infrastructure with an emphasis on roads. Capital investment in transport infrastructure is vital to continue to grow the economy and allow businesses to access larger labour markets.

The UK's transport system needs investment. The UK frequently spends less (as a proportion of GDP) than countries such as Canada, France and Switzerland and a recent survey put the UK as 27th in the world for perceived infrastructure quality[1]. It is also unsurprising that the Chancellor has focused on roads: investment in roads between 1995 and 2014 increased by 48% while rail investment increased by 227%. This meant that while 68% of the combined road and rail budget in 1995 was invested into roads, the proportion fell to 49% in 2014[2].

Aside from the clear, long term economic benefits, investing in transport can help to stimulate the economy and mitigate fears of economic slowdown stemming from Brexit uncertainties. However, this strategy is not without its own issues.

One of the difficulties of investing in transport as a stimulus is time. Large and complex projects take time to plan and deliver. As a result, the more 'shovel ready' projects are, the sooner the investment impact is felt. Whilst not all projects prove as 'shovel-ready' as they might first seem, subsequent governments have recognised that investment in transport infrastructure is an available lever to stimulate economic growth. Expenditure in real terms is correlated with expenditure as a proportion of GDP (Figure 2) and this trend appears to hold during recessionary periods too, albeit it is less pronounced. This indicates that the increase in expenditure as a proportion of GDP (at least) partly comes from increased government spending rather than simply because of the economy shrinking in size.

However, shortly after recessionary periods, spending appears to fall away. If a stimulus has created economic stability and the private sector feels confident to invest off the back of it, then the stimulus has been successful. If this isn't the case, inconsistent levels of public investment may mean that the full potential return on the investment is not realised.

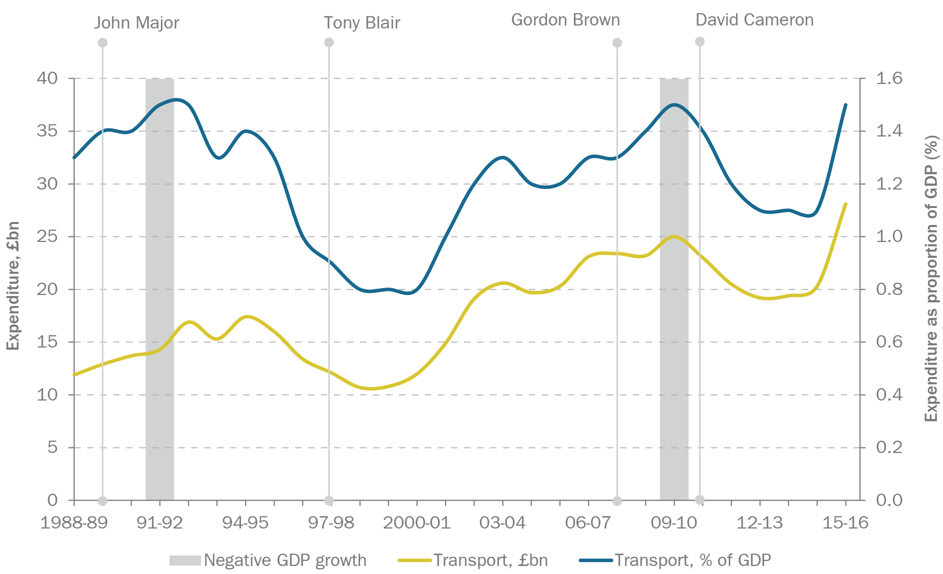
To make a step change in transport infrastructure investment, the UK will need to spend significantly more than we have in the past. Figure 2 shows that since 1988/89, real expenditure has grown but the expenditure as a proportion of GDP has remained constant indicating that the growth in expenditure has grown at a similar rate to the economy as a whole.

It is worthy of note that while the government can stimulate the economy through investment, its impact may also be curtailed because of the structure of investment has changed. In 1980, 96% of new infrastructure orders (not just transport but also energy, telecommunications etc.) were made by the public sector, while, by 2015, 59% of orders were made by the private sector[3]. Therefore, using transport investment as a stimulus requires both political will to spend additional money but also increasingly relies on sustained private sector confidence – perhaps a reason the Chancellor will continue the program of guaranteeing certain private investment in infrastructure via the UK Guarantees Scheme.

> *"We have chosen to borrow to kick-start a transformation in infrastructure and innovation investment. But we must sustain this effort over the long term if we are to make a lasting difference to the UK's productivity performance."*
>
> **Chancellor, Philip Hammond**
> November 2016

> *"This government recognises that for too long, economic growth in our country has been too concentrated in London and the south east. That's not just a social problem, it's an economic problem."*
>
> **Chancellor, Philip Hammond**
> November 2016

Figure 2 : Expenditure (revenue and capital) in transport infrastructure (real £; % GDP)



Source : HMT, NLP analysis

Footnotes

[1] OECD (2015) "Improving infrastructure", in OECD Economic Surveys: United Kingdom, Paris: OECD Publishing. paper: http://www.keepeek.com/Digital-Asset-Management/oecd/economics/oecd-economic-surveys-united-kingdom-2015/improving-infrastructure_eco_surveys-gbr-2015-6-en#.WCxtLrKLSUk#page3

[2] OECD (2016), Infrastructure investment (indicator). doi: 10.1787/b06ce3ad-en (Accessed on 22 November 2016)

[3] NLP – Devolving Growth? (2015)

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Where does transport investment go?

The Government's direction is clear – they will invest in transport infrastructure to boost productivity, act as a catalyst for devolution and send a clear signal to the markets post-EU referendum. The next stage is to identify the projects the Government will prioritise – the Chancellor has already announced the funding of the Oxford-Cambridge expressway and they will also bring forward funding to accelerate construction of the East-West Rail line. However, recent history has shown that not all regions have benefited from the same levels of transport investment.

Since 2006/07, transport investment has not been distributed equally across the country. The combination of London, the South East and the East of England – grouped together as the 'Greater South East' because their transport infrastructure is often linked together – received £6.4bn in 2014/15. This is 2.5 times more than the Northern Powerhouse regions (the North East, the North West and Yorkshire and the Humber) and 3.7 times that of the Midlands Engine (West and East). However, this masks the growth in investment over the period – the expenditure on transport in the Northern Powerhouse grew by 44% while in the Greater South East and the Midlands it grew by 36% and 35% respectively.

Transport investment should, to some degree, be correlated with population – the larger the population, the greater the need for a range of transport provision. However, after taking population into account, the story remains the same. The Greater South East spends over £1,069 per person on transport while the Northern Powerhouse and the Midlands spend £766 and £463 per person, respectively. The lowest spend per head is in the South West – £193 per person. Moreover, only two places had a higher transport spend per head in 2014/15 compared to 2006/07 – the Northern Powerhouse (3% gain) and Wales (7% gain).

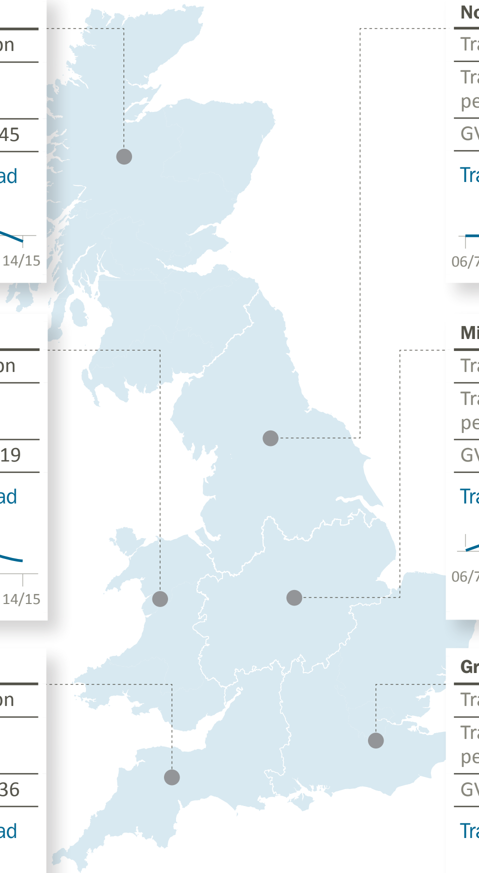
Crucially for policy makers, there is a positive correlation between transport investment per head and economic output per head at a regional level but the direction of causation is extremely important here. Economic theory would suggest that an increase in infrastructure investment should bring benefits to businesses and facilitate economic growth.

However, is investment in infrastructure only going to those places that are already growing and what is the additionality that further investment is unlocking?

The Government must balance two key considerations when they decide on their transport investment strategy. The first is the return on investment: will additional public (and private, in many cases) funding unlock sufficient gains to the local and national economy? The second is politics: if the projects with the highest returns are found in one region, will they invest elsewhere?

A balanced approach to investment in transport will be important as this will allow the necessary stakeholders and planners – such as Highways England, Network Rail, local authorities and LEPs – to make the case for investment. The benefits of investment in transport are realised at some point in the future – a strong coalition of bodies, combined with a clear and stable policy direction, should make investment more impactful.

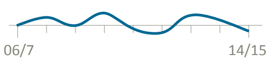
Figure 3 : Transport spending and GVA **(2014/15)**



Scotland

Transport spend	£1.4 bn
Transport spend per head	£514
GVA per head	£22,245

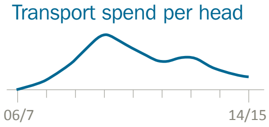
Transport spend per head



Wales

Transport spend	£0.6 bn
Transport spend per head	£320
GVA per head	£16,919

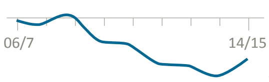
Transport spend per head



South West

Transport spend	£0.8 bn
Transport spend per head	£193
GVA per head	£21,536

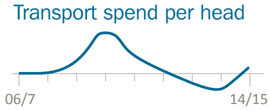
Transport spend per head



Northern Powerhouse

Transport spend	£2.6 bn
Transport spend per head	£766
GVA per head	£19,439

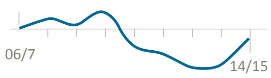
Transport spend per head



Midlands Engine

Transport spend	£1.7 bn
Transport spend per head	£463
GVA per head	£19,569

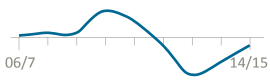
Transport spend per head



Greater South East

Transport spend	£6.4 bn
Transport spend per head	£1,069
GVA per head	£30,644

Transport spend per head



Source : HM Treasury; NLP analysis

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