

STATE OF WALES SPECIAL BRIEFING

2019 Outlook for Wales

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1. INTRODUCTION

Our latest assessment of what the next 12 months might hold has been one of the toughest yet. Wales and the UK face exceptional economic and political uncertainty: Brexit is just 13 weeks away yet the terms of the UK's departure are by no means clear, whilst the Prime Minister enjoys the support of just 200 out of 650 MPs. In Wales, the change of First Minister and new faces and new roles in the Cabinet could also bring unanticipated change. Never has Donald Rumsfeld's famous quote about 'unknown unknowns' been so apt.

That said, there are a number of changes ahead which can be anticipated, and a number of others about which it is possible to have a reasonable guess. Our forward look focuses on the 'known knowns', to quote Rumsfeld again, and even these do not make for comfortable reading. For people who are relatively comfortably off in their own homes, 2019 looks much like 2018 with some uncertainty about the annual holiday in Europe. For the less well-off, 2019 promises greater belt-tightening and, for a minority, real risks of not having a roof over one's head or enough to eat.

These are of course just forecasts. It is possible to change Wales' trajectory, at least on some issues. This report concludes with some practical steps that decision-makers can take that might make 2019 better than we anticipate.

2. ECONOMY

There is no shortage of forecasts for the UK economy in 2019. Our forecasts for Wales draw on UK estimates produced by OECD,¹ the Office for Budget Responsibility,² KPMG,³ PwC,⁴ EY Item Club,⁵ CBI⁶ and the British Chambers of Commerce.⁷ From these, we assess how the economy in Wales is likely to fare.

Brexit makes economic forecasting very difficult indeed. Virtually all forecasts assume that the terms of the UK's exit from the EU will be 'smooth' and 'orderly'. Even with these assumptions, most forecasts are downbeat, with analysts noting that the risks are on the downside – in other words the forecasts are optimistic.

Output

Forecasts of UK GDP range from 1.3% growth estimated by the British Chamber of Commerce to 1.6% estimated by OBR, PwC and KPMG. Even if the higher rate of increase is realised, the last ten years will be the second weakest decade of average annual GDP growth on record.⁸

For Wales, PwC forecast GDP growth will be at their forecast UK rate of 1.6%. While it is good news that the Welsh economy is expected to keep pace with the UK average, and outperform Northern Ireland, the North East of England and Yorkshire and Humberside, the rate of growth is not enough to close the gap with London and the South East. Wales will therefore continue to lag.

Several forecasters anticipate some sectors to struggle. PwC expect manufacturing output to grow at below the average for the economy as a whole, while other

analysts anticipate a continued squeeze on retail, hotels and restaurants. With signs that some big brands are already in trouble, 2019 could be the year that more famous names disappear from the high street.

The economic forecasts quoted above all assume that a Brexit deal is agreed by 29th March and that the UK leaves the EU with minimal disruption. The outlook is much worse if there is no Brexit deal or the UK's departure is not smooth. Many forecasts refer to a 'cliff edges', knife-edges' and 'storm clouds', but few put figures on the possible impact. KPMG forecast barely perceptible growth of 0.6% in 2019 and 0.4% in 2020 in the event of a no deal Brexit while PwC suggest there would be a mild recession.

Employment and unemployment

The recent growth in employment is widely anticipated to slow over 2019, with estimates of ranging from 0.5% to 0.6% growth across the UK. If Wales experiences the same rate of employment growth as the UK, total employment would rise by a mere 9,000. It is worth noting that these figures do not take into account any local economic shocks that might occur, for example if major local employers downsize or close as a result of Brexit or recession. Local labour markets dependent on struggling sectors, such as tourism or retail, could also be hard hit.

Unemployment is forecast to remain at around 4.0% for the UK as a whole. If Wales' unemployment rate mirrors the UK trend, the Welsh figure will continue at around the UK rate over 2019. However, it is unlikely that Wales' relatively good average performance will be enough to reduce the very high levels of unemployment in some areas. In the year to June 2018, unemployment was substantially above the Welsh rate in some local authorities, such as Rhondda Cynon Taf (7.2%), Caerphilly (7.0%) and Cardiff (6.8%). Unemployment is especially high for young males, at 14.7% for Wales, rising to nearly 1 in 4 16-24 year olds (24.1%) in Rhondda Cynon Taf and 1 in 5 (21.6%) in Neath Port Talbot.

3. STANDARD OF LIVING

The same forecasters of output and employment also typically predict inflation and wage increases as well. The same Brexit caveats apply to these estimates as to others.

Inflation

Inflation is expected to be modest over 2019, with the CPI hovering around 2.0 to 2.2%. The headline rate of inflation masks trends in different items. Food prices are expected to rise as a result of extreme weather and Brexit, with the Bank of England anticipating increases of up to 10%.⁹ Fuel prices are also expected to increase, despite the energy price cap coming into effect on 1st January 2019, not least because of the fall in the value of sterling.¹⁰

On housing costs, social rents in Wales will go up by less than in previous years, simply matching the rate of inflation at October 2018 of 2.4%.¹¹ House prices in Wales are expected to rise by between 1.5%¹² and 3%¹³ over the year, although there are likely to be greater local variations. For example the removal of tolls from the Severn Bridge and the prospect of the south Wales Metro could see new housing hot-spots emerge. There are no forecasts of private rents for Wales.

Transport costs are also likely to increase. Rail fares will rise by an average of 3.1% from 1st January 2019, and although bus fares are not regulated they have typically risen by above-inflation rates too. While petrol prices have fallen recently and are set to remain at late 2018 rates into early 2019, the rest of the year is more uncertain.¹⁴

Earnings

Over the year, wages are expected to slightly outpace inflation with average growth of 2.5% to 3%. For a male on median earnings in Wales, this is equivalent to an increase of £14.96 a week while for females on median earnings the increase is equivalent to £10.38 a week.

Workers aged 25 and over on the National Living Wage (NLW) will see their earnings rise by 38p per hour to £8.21 with effect from April 2019, an uplift of £14.06 a week for someone working 37 hours. During 2019 the UK Government is likely to review the previous Chancellor's commitment to raise the NLW to 60% of median earnings by 2020.

Income tax

April 2019 marks the introduction of the first Welsh rate of income tax, although for the time being the rate – 20p in every pound - is no different to that for the rest of the UK. There will also be a change in the tax threshold – which is outside the scope of the Welsh Government - to £12,500 a year. This increase will remove anyone working less than 30 hours a week at the NLW from taxation altogether, as well as reducing the tax liability of all workers earning above that sum.

Benefits

There is no let-up for households in receipt of most benefits. Most working-age benefit rates continue to be frozen at 2015 levels. For example income-based Jobseeker's Allowance will continue at £73.10 a week for over-24 year olds, with the same rate applying to recipients of Employment and Support Allowance. Some benefits will be uprated, such as Carer's Allowance and Personal Independence Payment (by £1.55 and £2.05 a week respectively), and working families in receipt of Universal Credit will benefit from changes to work allowances.¹⁵

The roll-out of Universal Credit – originally scheduled to have been completed in 2017 – will dramatically slow down. Only households making new claims for working-age benefits or notifying a change of circumstance will be moved onto Universal Credit. No more than 10,000 other claimants across the UK are expected to be switched from existing benefits to UC over the year.¹⁶ While pausing migration of

claimants might stem the difficulties reported by claimants, there will be sufficient new claims to keep Universal Credit in the spotlight.

On pensions, the new state pension comes into force from 1st April at £168.60 a week. Over the year, the state pension age for men and women begins to increase to 66 years of age. People born in April 1954 who previously would have reached state pension age in April 2019 at the age of 65, will now have to work until September 2019 before collecting their state pension.¹⁷

Poverty and inequality

Inequality is widely expected to increase during 2019. The combination of tax and benefit changes is expected to result in better-off households gaining in both cash and percentage terms compared with poorer families. The Resolution Foundation estimates that the poorest tenth of households will be £30 a week better off as a result of tax and benefit changes in 2019/20 – a 0.33% rise - whereas the richest tenth will be £410 a week better off, a 0.41% rise.¹⁸

Given the modest upward trend in earnings and the squeeze on benefits, it is highly likely that poverty rates will increase. The Institute for Fiscal Studies has forecast an increase of around 3 percentage points in relative income poverty amongst working age adults in Wales by 2019/21, and a rise of around 10 percentage points in relative child poverty by this date.¹⁹ Pensioner poverty is forecast to remain broadly unchanged.

As well as changes in the headline rates, we can also anticipate an increase in the depth of poverty, with more households having to seek emergency help from food banks, being unable to afford food in the school holidays, and lacking essentials such as hygiene products or warm clothing.

4. SOCIETY

This section looks at how Wales society might change. It is slightly different to the preceding sections because not only does society generally change more slowly than the economy, there are many fewer forecasts of social change.

Population

Wales' population is forecast to increase by approximately 11,000 people in 2019/20. Almost all the increase is expected to be due to net migration, primarily international. Natural change - 34,000 births and 32,000 deaths – will make a very small contribution to population growth in the year.²⁰ Projections are highly dependent on assumptions about fertility, life expectancy and in- and out-migration. Changes such as reduced net migration because of Brexit could result in Wales' population declining over the year.

Long-term shifts in the structure of the population will be evident in 2019. As well as the number of people aged 65 and over being expected to increase by nearly 9,700, there are also forecast to be around 3,700 more children aged 15 and under.²¹ At the

same time the population of working age is anticipated to continue its downward trend, falling by 1,200.

Health and social care

The year ahead is likely to see continued pressure on health and social care services. The increasing number of older people and the higher rates of illness experienced by them, coupled with the impact on health of poverty and deprivation, will fuel demand across the board. Waiting times in A&E and for treatment can be expected to rise.

Nobody is likely to have the stomach to talk about the reorganisation of secondary care. Labour leadership candidate Vaughan Gething floated the idea of a National Care Service in his manifesto – with him back as Health and Social Care Minister expect to see the idea being developed.

Education

Many of the major changes in education in Wales have already been announced, with 2019 being a period of implementation. However a decision on the proposed Tertiary Education and Research Commission, floated early in 2018, must surely be imminent.

The new First Minister's manifesto has promised changes such as extending school uniform grant and free school meals eligibility, strengthening links between schools and further education colleges and the community, and improvements to teacher education and specialist support services. However the timeline for these commitments is unclear, although a decision on free school meals is scheduled for April.

Given the lack of other activity, we can expect a continued focus on attainment at age 16. If GCSE performance in summer 2019 reflects 2018, then around 16,000 young people will leave school without 5 GCSEs at grades A* - C including maths and English or Welsh. Not attaining at this level typically means young people are unable to continue to A level study, instead looking for employment, traineeships or vocational education.

The focus on attainment will be fuelled further by the publication of the results of PISA 2018 at the end of 2019.²² It seems highly unlikely that Wales' ranking will change radically.

Higher education could come under further pressure in 2019 as a result of competition affecting student numbers, and Brexit affecting research income and the recruitment and retention of international staff and students. Despite this, the question of reorganisation and rationalisation is unlikely to be on the agenda.

5. POLITICS AND GOVERNMENT

With 2019 set to be one of the most politically uncertain years ever, forecasts are thin on the ground. There can be few who would bet on what 2019 might hold.

The UK political scene looks set to continue to be riven with tension, at least in the first half of 2019. There is potential for a second referendum, a general election and at least one new political leader. It's a moot point how much the electorate appreciates UK politicians' performances, with a real risk of further alienation of voters from politics as the issues that affect their everyday lives seem to be sidelined.

For Wales, 2019 brings new faces at the helm of all political parties. The new First Minister's manifesto provides a clear statement of principles, but it remains to be seen whether his plans will be sufficient to 'push the boundaries of the Assembly's powers to help people fulfil their potential'.²³ This, together with new Cabinet members, could also bring a change in style of government. The new Cabinet members could also bring a change of direction in their fields. The new opposition leaders could well bring greater energy and challenge to debate in the Senedd as they seek to make their mark.

With the next Assembly elections three years away, we can also expect parties to begin the manifesto process during the year.

A number of independent reviews of policy are due to complete during 2019. The Fair Work Commission and the Review of Affordable Housing are both scheduled to report in April. With both having had tight – if not impossible – timescales, expect mostly headline-y conclusions with a lot more detailed work to be undertaken. The Commission on Justice is also due to report in 2019, and with a significantly longer timeline for its deliberations could well make radical proposals for a Welsh justice system.

6. CONCLUSIONS

The outlook for 2019 does not make for comfortable reading. Even the most optimistic of forecasts are of sluggish growth in output and employment, with wage rises barely exceeding inflation. Pressure on public services is likely to increase, and there is unprecedented political uncertainty at least at UK level. With most forecasts assuming a 'smooth Brexit', the prediction of modest economic growth could yet prove unrealistic.

The disappointing outlook is coupled with a strong likelihood of increasing poverty and inequality. While all people are at risk, it is young people, the least well-off and

some communities, notably in the south Wales valleys, which will bear the brunt of lack of opportunities and a decline in living standards over 2019.

The important point about forecasts is that they are not inevitable. The outlook for 2019 should serve as a wake-up call to the Welsh Government, local authorities, and others in the public, private and third sectors of the need for a radical change in approach. While there is much that the Welsh Government and others do not control, there are actions that can be taken.

- **Rethink economic policies:** despite some shifts, the Economic Action Plan is rooted in an economic model that is self-evidently in decline. Instead the focus should be on building a resilient and inclusive economy, through stimulating the foundational economy, new start-ups, social enterprise and SMEs, and which prioritises the weakest local economies.²⁴
- **Build an inclusive labour market:** labour market policy is fragmented across portfolios. Instead, designate Cabinet responsibility for employment participation, skills and employability, progression, and quality of work in a single role, and join-up policies and fill gaps.²⁵
- **Take action to solve poverty:** with poverty deepening and increasing, all organisations should have clear plans to protect people on the lowest incomes, and adopt strategies to raise incomes and cuts costs for the least well-off.²⁶
- **Provide better opportunities for young people:** with barely half of school leavers getting good GCSEs, improving attainment at 16 and creating a better range and quality of opportunities at all levels of ability should be a priority.²⁷
- **Transform public services:** the pressure on public services is unsustainable. Protecting core services may require difficult decisions about cuts to others. It is time for an informed debate about what public services are for, what people expect from them and – crucially – how much they are willing to pay for them.

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