



The Law Society

## **Forecasts of legal services sector real turnover and net exports**

**August 2014**

Released: 28 August 2014





## Contents

	<b>Page</b>
<b>Summary</b>	<b>3</b>
<b>Forecasts of real turnover of the UK legal services sector</b>	<b>5</b>
<b>Forecasts of net exports of the UK legal services sector</b>	<b>8</b>
<b>Potential effects on legal services of slower growth in households' real incomes and a slowdown in housing market activity</b>	<b>10</b>
<b>Appendix 1 - Full forecast figures</b>	<b>13</b>
<b>Appendix 2 - Structure of legal services sector forecasting model</b>	<b>14</b>
<b>Contacts details for further information</b>	<b>16</b>



## Summary

### Legal services sector forecasts of real turnover and net exports

	2012	2013	2014	2015	2016	2017	2018
Real turnover (£bn 2010 prices)	£27.11bn	£28.04bn	£29.12bn	£30.54bn	£31.76bn	£33.01bn	£34.44bn
% change	1.5	3.5	3.8	4.9	4.0	3.9	4.3
Real net exports (£bn 2010 prices)	£3.16bn	£3.28bn	£3.37bn	£3.64bn	£3.90bn	£4.17bn	£4.46bn
% change	1.4	3.8	3.0	7.9	7.2	6.8	6.9
Net exports as % turnover	11.64%	11.68%	11.59%	11.92%	12.28%	12.62%	12.93%

Source: Law Society (Aug 2014)

- The current (August 2014) Law Society forecasts expect growth in real turnover of 3.8% in 2014, increasing to 4.9% in 2015, which is near to pre-recession levels. This compares to the most recent ONS figures for the sector which show real turnover growth of 1.5% in 2012, and Law Society estimates of growth of 3.5% in 2013.
- Expected growth of real turnover in 2014 and 2015 is now significantly higher than the Law Society's previous (December 2012) forecasts, and reflects upward revisions to the outlook for the UK economy by macroeconomic forecasters.
- The main factors driving growth in legal services real turnover in 2013 were the improvement in the performance of the UK business sector and the significant increase in housing market activity.
- Improvements in the performance of the UK business sector and the increase in the housing market are expected to continue to be significant drivers of growth in legal services real turnover in 2014 and 2015.
- Most economic forecasters currently expect households' real incomes to begin growing again during 2014 and show significant growth in 2015, and this will make an increasing contribution to growth in legal services real turnover. As the economy continues to recover, the labour market is expected to tighten and overall productivity in the economy is expected to improve, leading to increases in people's real earnings.
- An estimated 1.0% of the growth in the real turnover of the legal services sector in 2014 is due to expected growth in households' real incomes, increasing to 1.5% in 2015.
- Growth in households' real incomes in 2014 and 2015 will also help to sustain the recovery in housing market activity, although some slowdown in the rate of recovery in the housing market is expected from the very high rates of growth seen over the past year.
- However, there is significant uncertainty around the forecasts for households' real income growth. The Law Society forecasts are based on NIESR forecasts that households' real incomes will grow by 2.0% in 2014 and by 2.9% in 2015. Based on our model, if real



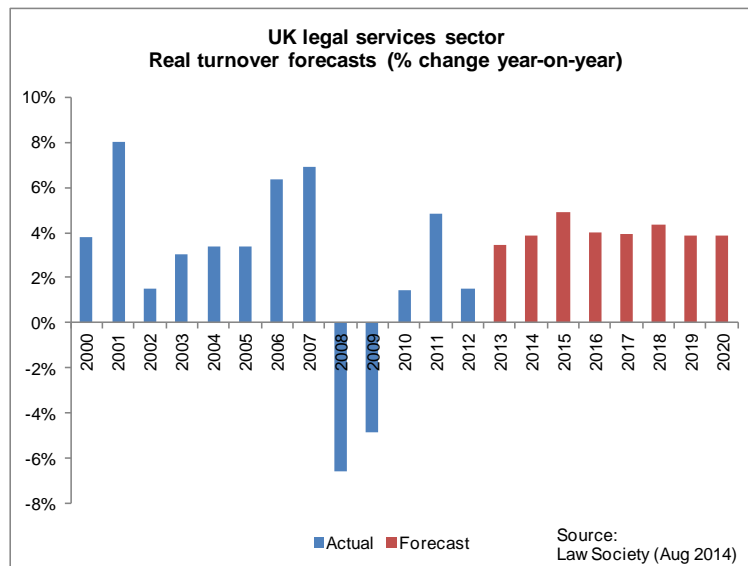
households' real incomes instead grow by only 1.0% in each of these years then, the growth in real turnover would be 2.6% in 2014 and 2.7% in 2015, instead of the currently forecast 3.8% and 4.9% respectively.

- The Law Society estimates that net exports increased by 3.8% in 2013 and currently expects a further 3.0% increase in 2014. Growth is forecast to increase to 7.9% in 2015 as expected higher growth in both the advanced economies and emerging economies in 2014 and 2015 gradually feeds through into demand, improving the legal sector's net export performance.



## Forecasts of real turnover of the UK legal services sector

The rate of growth in real turnover of the UK legal services sector is estimated to have increased between 2012 and 2013, and is expected to continue to increase in 2014 and 2015, with growth in 2015 likely to be near to pre-recession levels. The current (August 2014) Law Society forecasts expect growth in real turnover of 3.8% in 2014, increasing to 4.9% in 2015. This compares to the most recent ONS figures for the sector which show real turnover growth of 1.5% in 2012, and Law Society estimates of growth of 3.5% in 2013. During the recession real turnover fell significantly, whereas in the pre-recession period 2000-2007 the average rate of growth in real turnover was 4.5% per year.



Expected growth of real turnover in 2014 and 2015 is now significantly higher than the Law Society's previous (December 2012) forecasts when growth of 1.9% for 2014 and 2.8% for 2015 was expected, and reflects upward revisions to the outlook for the UK economy by macroeconomic forecasters. The latest NIESR forecasts (May 2014) expect UK GDP to grow by 2.9% in 2014 (up from 1.7% in the October 2012 NIESR forecasts) and by 2.4% in 2015 (up from 2.1% in the October 2012 NIESR forecasts).

### **Factors driving growth in legal services sector real turnover**

The Law Society's short-to-medium term forecasting model for real turnover in the legal services sector is based on 6 main economic drivers of growth:

- (1) the performance of the UK business sector measured by its real profits
- (2) households' real disposable incomes
- (3) housing transactions
- (4) the unemployment rate (as a proxy for crime rates and social deprivation)
- (5) financial sector output
- (6) net exports of legal services in real terms



- ***performance of the UK business sector and housing transactions***

The main factors driving growth in legal services sector real turnover in 2013 were the improvement in the performance of the UK business sector and the significant increase in housing market activity. Real turnover is estimated to have increased by 3.5% in 2013, of which an estimated 0.8% was due to the improvement in the performance of the UK business sector, and 2.7% was due to the increase in the housing market. These two factors therefore accounted for almost all of the growth in real turnover of the legal services sector in 2013.

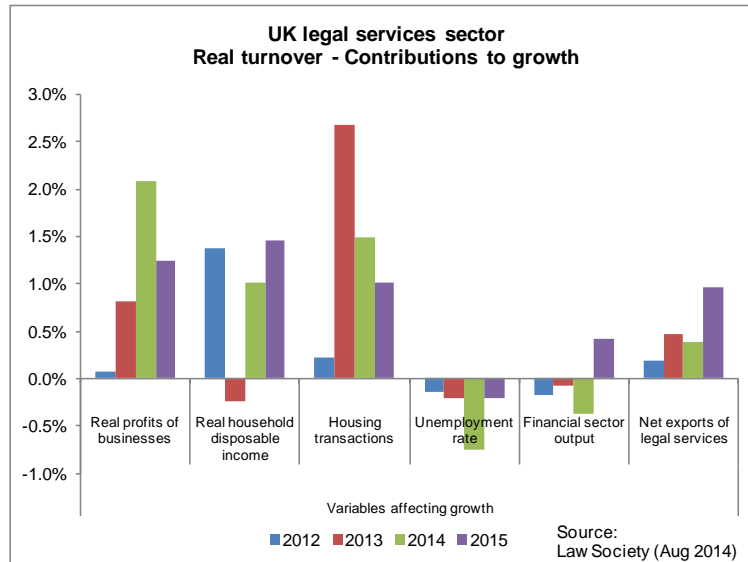
The increase in housing market activity has been particularly significant as the contraction in housing market activity was a major factor behind the decline in retail legal business during the recession. The Law Society estimates that the growth in real turnover between 2007 and 2010 was over 10% lower than it would have otherwise been due to the significant fall in housing market activity over this particular period.

Improvements in the performance of the UK business sector and the increase in the housing market are expected to continue to be significant drivers of growth in legal services real turnover in 2014 and 2015. Real turnover is expected to increase by 3.8% in 2014, of which 2.1% is due to the improvement in the performance of the UK business sector, and 1.5% is due to the increase in the housing market. In 2015, real turnover is expected to increase by 4.9%, of which 1.2% is due to the improvement in the performance of the UK business sector, and 1.0% is due to the increase in the housing market.

- ***households' real disposable incomes***

Most economic forecasters currently expect households' real incomes to begin growing again during 2014 and show significant growth in 2015, and this will make an increasing contribution to growth in legal services real turnover. As the economy continues to recover, the labour market is expected to tighten and overall productivity in the economy increase, leading to increase in people's real earnings.

An estimated 1.0% of the growth in the real turnover of the legal services sector in 2014 is due to expected growth in households' real incomes, increasing to 1.5% in 2015. This compares to 2013, when real turnover increased by 3.5%, but households' real incomes fell and had a negative contribution to growth of -0.2%, and growth in 2013 was entirely attributable to the improvement in the performance of the UK business sector and the increase in the housing market. Growth in households' real incomes in 2014 and 2015 will also help to sustain the recovery in housing market activity, although some slowdown in the rate of recovery in the housing market is expected from the very high rates of growth seen over the past year.



- ***financial sector output and net exports of legal services***

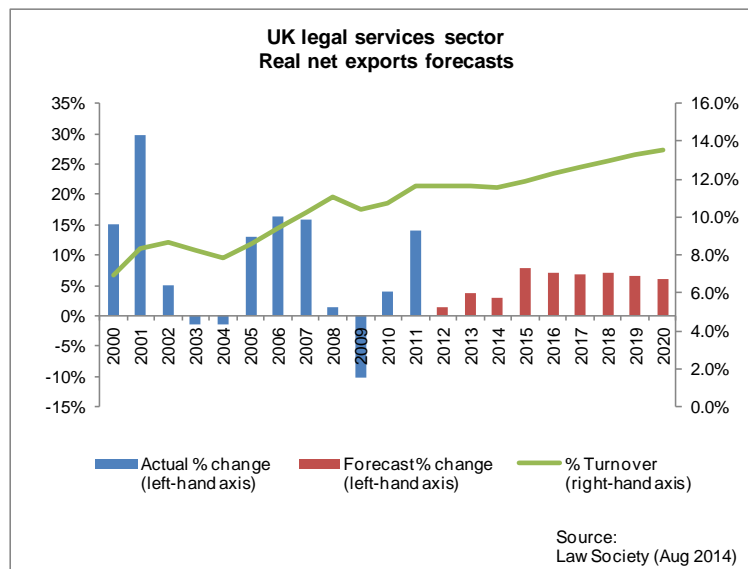
Growth in the output of the UK financial sector and increasing exports of legal services have both been significant contributors to the growth in real turnover of the legal services sector over the longer term. Between 2000 and 2009, real turnover increased by 28%, of which an estimated 9% was due to growth in the output of the UK financial sector, and 11% was due to increasing (net) exports of legal services.

However, the fall in financial sector output since 2008 has had a significant negative effect on growth in real turnover of the legal services sector, and is expected to continue to have a negative effect on growth in real turnover of the legal services sector in 2014. Financial sector output is expected to increase in 2014 and 2015 which will feed through into the demand for legal services, but the effect on growth in real turnover of the legal services sector will be relatively low compared to the high levels of contribution financial sector growth has made to growth in the past.



## Forecasts of net exports of the UK legal services sector

Although net exports of legal services have been a significant contributor to the growth in real turnover of the legal services sector over the longer term, growth in net exports is estimated to have been relatively slow in 2013, and similar growth is expected for 2014, although growth is expected to increase in 2015. The Law Society estimates that net exports increased by 3.8% in 2013 and currently expects a further 3.0% increase in 2014, rising to 7.9% in 2015.



### Factors driving net exports of legal services

The Law Society's short-to-medium term forecasting model for real net exports of the legal services, which feeds into the forecasts of real turnover, is based on 3 main economic drivers of growth:

- (1) average GDP in the advanced economies
- (2) average GDP in the emerging economies
- (3) the pound sterling exchange rate (weighted average against the US\$ and €)

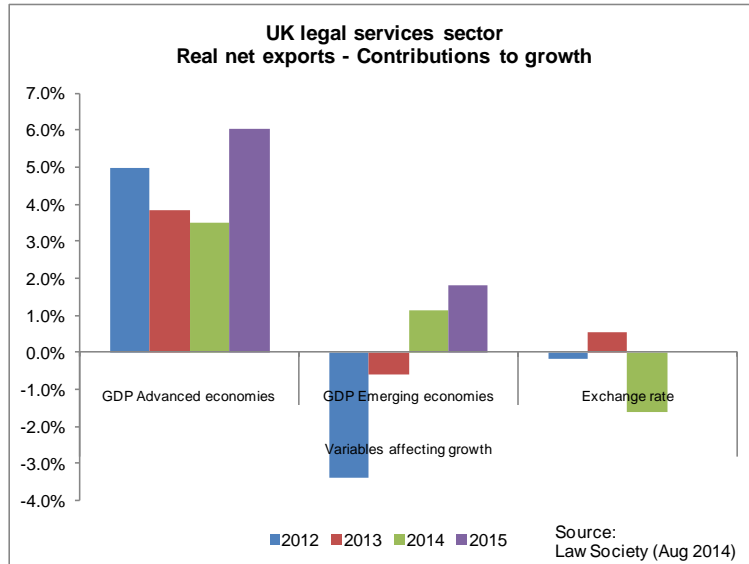
The main factor behind the low growth in 2013 and 2014 has been low growth in the advanced economies, which account for the majority of UK legal services exports, but also falling/low growth in the emerging economies. The strength of the pound in 2014 is also likely to have had a negative effect on net exports.

Expected higher growth in both the advanced economies and emerging economies in 2014 and 2015 will gradually feed through into demand, improving the legal sector's net export performance, and the main effects on net exports are likely to be seen in 2015. The latest full IMF forecasts (April 2014) estimate average GDP growth in the advanced economies to have been 1.5% in 2013, and expect growth of 2.2% in 2014 and 2.3% in 2015. Estimated average GDP growth in the emerging economies was 5.6% in 2013, and expected growth in 2014 is 4.9% and 5.3% in 2015. The





macroeconomic forecasts that feed into the net exports model are also based on no further significant strengthening of the pound against the US\$ or the euro.

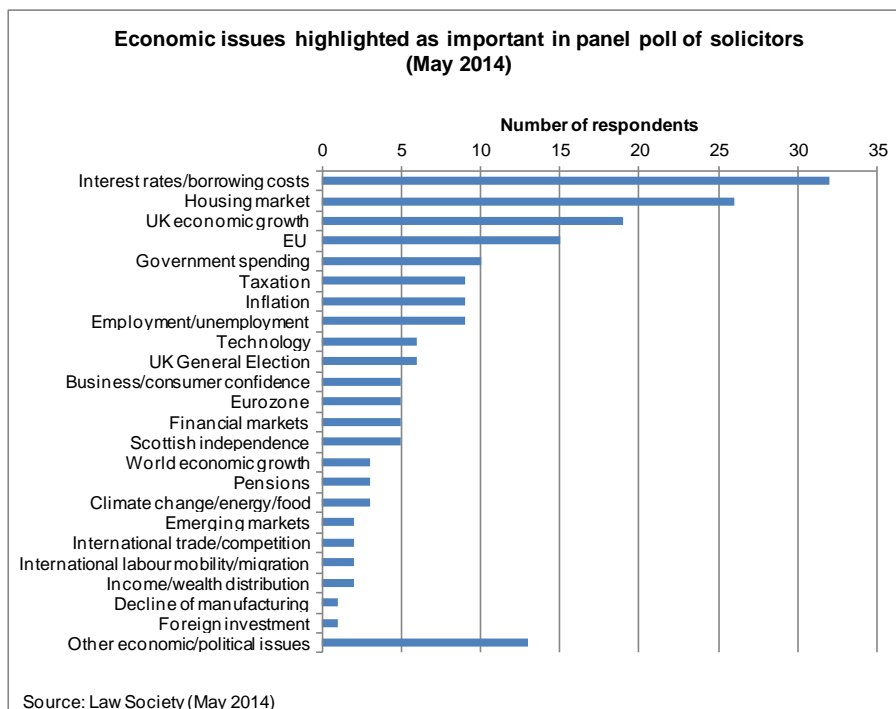




## Potential effects on legal services of slower growth in households' real incomes and a slowdown in housing market activity

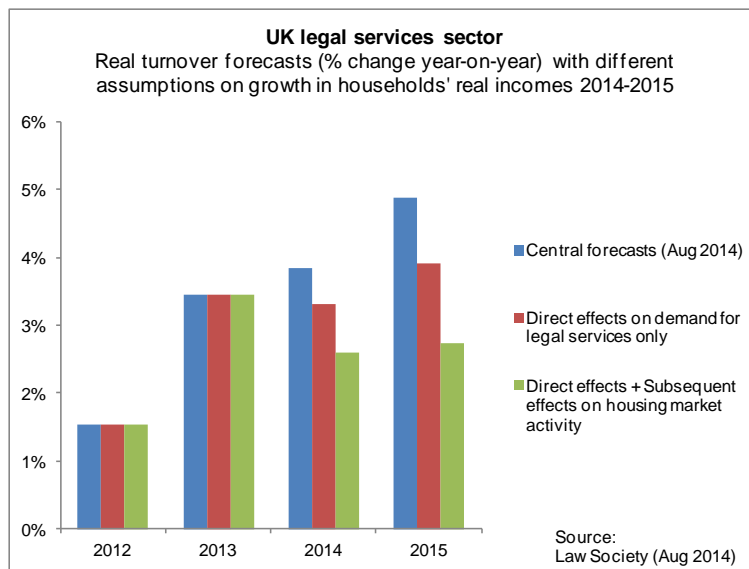
The forecast that households' real incomes will begin growing again during 2014 and show significant growth in 2015 is an important driver of the forecast growth in real turnover of the legal services sector. Real incomes affect legal services through: (1) their direct effects on the demand for legal services, and (2) their subsequent effects through the housing market, given that real incomes are the main driver of housing market activity in the longer-term. However, there is significant uncertainty around the forecasts for households' real income growth, and recent figures indicate that people's real earnings have continued to fall even though total employment has been rising and the inflation rate has remained relatively low. Growth in household's real incomes is also important for overall economic growth in the economy as consumer spending is by far the largest component of total GDP.

A panel poll recently undertaken by the Law Society (the Law Society's Member Insight Panel) also asked solicitors which economic issues they felt could potentially have a significant effect on their businesses. The second most important economic issue solicitors were concerned about was the longer-term outlook for the housing market, and the third most important issue was the longer-term outlook for UK economic growth. (The first issue solicitors were concerned about was the outlook for interest rates/borrowing costs, and the fourth was the possibility of UK disengagement from the EU). The Law Society has therefore used its legal services forecasting model to try to quantify the potential effects on the demand for legal services of slower growth in households' real incomes and a slowdown in housing market activity.





The Law Society forecasts are based on NIESR forecasts that households' real incomes will grow by 2.0% in 2014 and by 2.9% in 2015. Based on our model, if households' real incomes instead grow by only 1.0% in each of these years then, taking into account only the direct effects on demand, the growth in real turnover would be 3.3% in 2014 and 3.9% in 2015, instead of the currently forecast 3.8% and 4.9% respectively. Taking into account both the direct effects on demand and the subsequent effects through the housing market, the growth in real turnover would be 2.6% in 2014 and 2.7% in 2015.



**Effects on forecasts of real turnover of slower growth in households' real incomes in 2014 and 2015**

	2012	2013	2014	2015
Central forecasts (Aug 2014)	1.5%	3.5%	3.8%	4.9%
Direct effects on demand for legal services only	1.5%	3.5%	3.3%	3.9%
Direct effects + Subsequent effects on housing market activity	1.5%	3.5%	2.6%	2.7%

Source: Law Society (Aug 2014)

Slower growth in households' real incomes and a slowdown in housing market activity would therefore potentially have a significant effect on the legal services sector, and also the effects would affect certain types of firms. Solicitor firms undertaking a significant amount of retail work are typically two-third the average size of solicitor firms as a whole, and firms undertaking a significant amount of residential conveyancing work are typically one-third the average size.



#### Average size of solicitor firms

	Solicitor firms undertaking a significant amount of:		All solicitor firms
	Retail work (including residential conveyancing)	Residential conveyancing work	
Turnover per firm (£k)	£832k	£454k	£1,904k
Partners per firm	3.0	2.2	4.4
Solicitors per firm	6.0	3.4	8.8
Fee-earners per firm	8.5	4.5	12.3

Source: Law Society Market Assessment Report 2012/13



## Appendix 1 - Full forecast figures

UK legal services sector Real turnover			Real net exports of legal services			Net exports as % turnover
	£bn 2010 prices	% change per year		£m 2010 prices	% change per year	Average over period
2005	24.85	3.4	2005	2140	13.0	8.6%
2006	26.42	6.3	2006	2488	16.2	9.4%
2007	28.25	6.9	2007	2882	15.8	10.2%
2008	26.39	-6.6	2008	2922	1.4	11.1%
2009	25.11	-4.9	2009	2620	-10.3	10.4%
2010	25.46	1.4	2010	2726	4.1	10.7%
2011	26.69	4.8	2011	3111	14.1	11.7%
2012	27.11	1.5	2012	3155	1.4	11.6%
2013	28.04	3.5	2013	3275	3.8	11.7%
2014	29.12	3.8	2014	3375	3.0	11.6%
2015	30.54	4.9	2015	3640	7.9	11.9%
2016	31.76	4.0	2016	3901	7.2	12.3%
2017	33.01	3.9	2017	4166	6.8	12.6%
2018	34.44	4.3	2018	4455	6.9	12.9%
2019	35.77	3.9	2019	4749	6.6	13.3%
2020	37.15	3.9	2020	5042	6.2	13.6%
		Average % change per year over period			Average % change per year over period	Average over period
1996-2000		5.5	1996-2000		17.4	6.7%
2001-2005		3.8	2001-2005		8.4	8.4%
2006-2010		0.5	2006-2010		5.0	10.4%
2011-2015		3.7	2011-2015		6.0	11.7%
2016-2020		4.0	2016-2020		6.7	12.9%
2021-2025		3.7	2021-2025		5.8	14.4%
2026-2030		3.5	2026-2030		5.9	16.1%

Source: Law Society forecasts (Aug 2014)

Forecasts based on  
NIESR/IMF macroeconomic forecasts  
(Apr/May 2014)



## Appendix 2 - Structure of legal services sector forecasting model

The Law Society's short-to-medium term forecasting model for real turnover in the legal services sector is based on 6 main economic drivers of growth:

- (1) the performance of the UK business sector measured by its real profits
- (2) households' real disposable incomes
- (3) housing transactions
- (4) the unemployment rate (as a proxy for crime rates and social deprivation)
- (5) financial sector output
- (6) net exports of legal services in real terms

There is also a simple relationship between households' real disposable incomes and housing transactions to enable simulations of different growth rates in real incomes.

The forecasting model does not explicitly take into account longer-term factors that could also affect real turnover such as: increasing competition, technological change, more flexible working practices, or the increasing importance of other jurisdictions. Therefore, although the model is run up to 2030, the longer-term forecasts should obviously be treated with some caution.

The model also does not explicitly include any effects of the recent changes to legal aid scope and eligibility, and rates, on total legal services sector turnover, although it is likely to capture the underlying demand for legal aid services. The Law Society is however monitoring the potential effects of the recent changes on total turnover.

The backdata on turnover is from the ONS's Annual Business Survey (ABS), and is converted to 'real' terms using the ONS's legal services producer price index

The Law Society's short-to-medium term forecasting model for real net exports of the legal services, which feeds into the forecasts of real turnover, is based on 3 main economic drivers of growth:

- (1) average GDP in the advanced economies
- (2) average GDP in the emerging economies
- (3) the pound sterling exchange rate (weighted average against the US\$ and €)

The backdata on net exports is from the ONS's Supply and Use Tables (SUTs) figures on exports of legal services minus imports of legal services, and like the turnover figures, is converted to 'real' terms using the ONS's legal services producer price index.

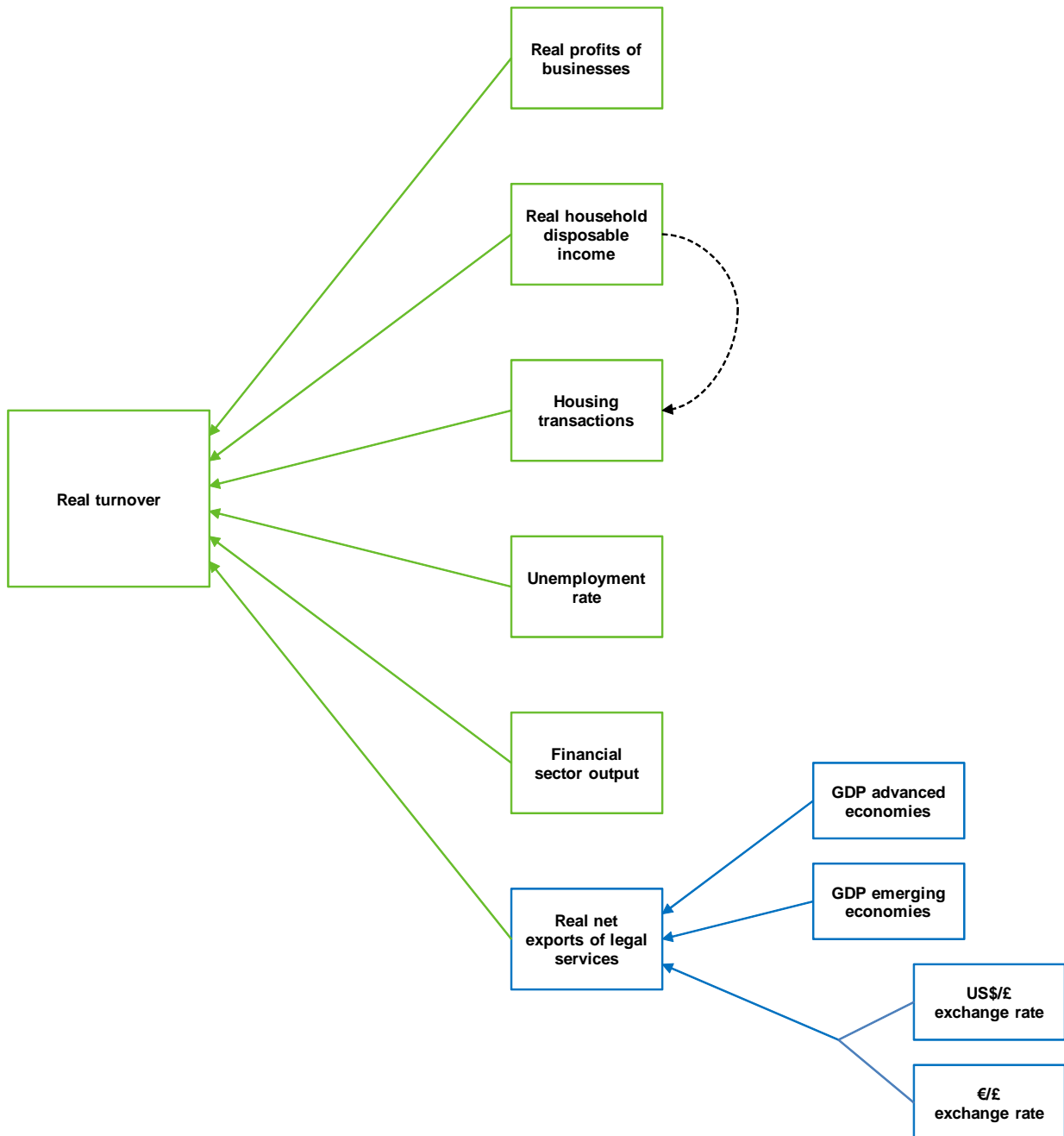
The exchange rate used in the net exports forecasting model is a 'weighted average' of the rate against the US\$ and the rate against the Euro, where the weights are given by the relative share of legal services exports going to the Eurozone and the share going to the Rest of the World.

The relationships in the real turnover and net exports models are estimated using econometric techniques and are based on data over the period 1995-2012. The econometric models are restricted by the amount of data available, but do track past movements in real turnover and net exports reasonably well. The forecasts are for the total legal services sector ie solicitors + barristers + other legal services providers.



The forecasts for the UK macroeconomic variables that feed into the models are those produced by the National Institute of Economic and Social Research (NIESR). The forecasts for GDP in the advanced and emerging economies that feed into the real net exports are IMF forecasts.

### Legal services sector forecasting model





The Law Society

## **Contacts details for further information**

For further information on the legal services sector forecasts please contact:

Keith Blakemore  
Senior Economist  
Law Society

Email [keith.blakemore@lawsociety.org.uk](mailto:keith.blakemore@lawsociety.org.uk)

or

Nina Fletcher  
Head of Research  
Law Society

Email [nina.fletcher@lawsociety.org.uk](mailto:nina.fletcher@lawsociety.org.uk)