Regional Monitor January 2018

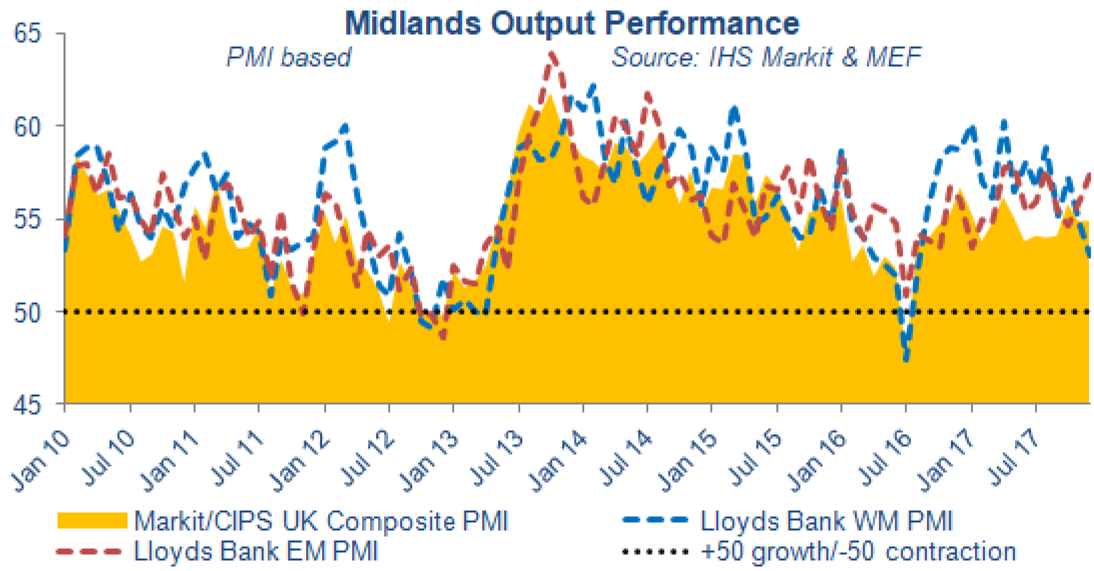
Latest Global Trends, Regional PMI, Output Data, Trade Conditions & Brexit Update

Days since Article 50 activation: 292 **Remaining Brexit Negotiating Days: 45?**

- EM PMI up to 57.5 from 56 in November, whilst WM posted 53 in December, easing from 54.6 previously.
- UK composite PMI up slightly to 54.9 from 54.8 previously.
- Employment growth in the Midlands was the strongest in the UK
- Price pressures, although easing, remain acute; with raw material costs now the largest driver of input cost increases.
- Business confidence in the Midlands grew in December, with firms optimistic about 2018.
- £ expected to appreciate towards US$1.50 by year-end, as confidence in British economy firms and prospects for favourable Brexit conclusion improve.
- Compulsory liquidation of Carillion issues expected to pose considerable challenges for British authorities.
- Birmingham 2022 Commonwealth Games anticipated to give immediate boost to regional economy, sustained through until 2022 and beyond.

Output in the Midlands continued to grow in December 2017, with the IHS Markit England and Wales Regional PMI posted 57.5 for the EM in December, up from 56 in November, while the WM was 53, easing from 54.6 previously. The UK PMI was 54.9 in December, from 54.8 in November.

Growth in both the EM and the WM was driven by increased new orders, although increases in new orders softened slightly across the region in December, and remaining faster than the UK overall. Demand was robust from both domestic and foreign markets in the EM, whilst the WM saw demand growth predominantly from abroad.

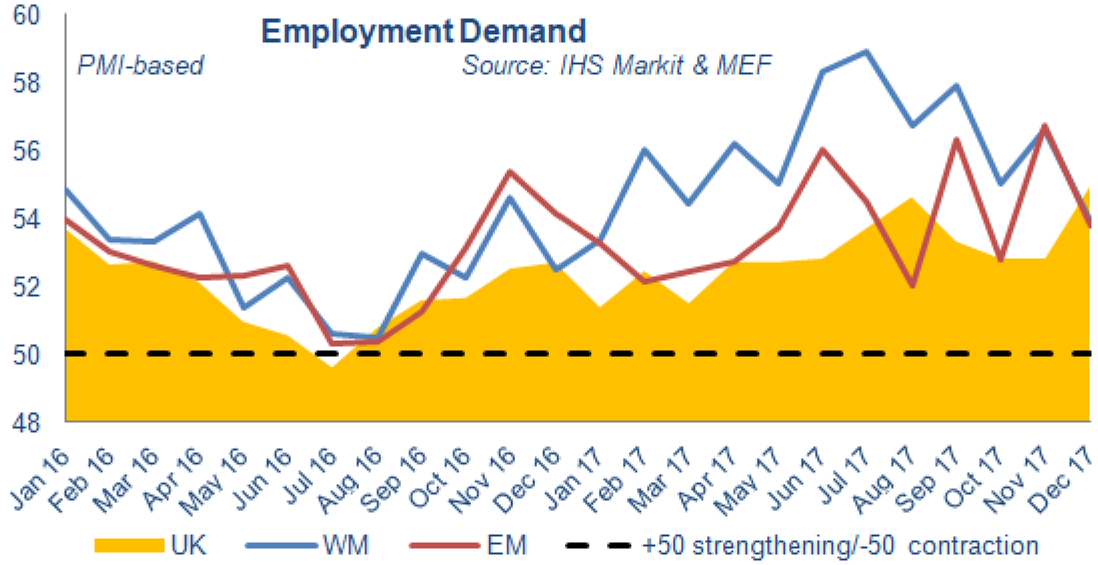


This was reflected in the UK sector PMIs, which showed rising output in all three industries, manufacturing, construction and services, although this growth was more subdued in December than in November for manufacturing and construction.

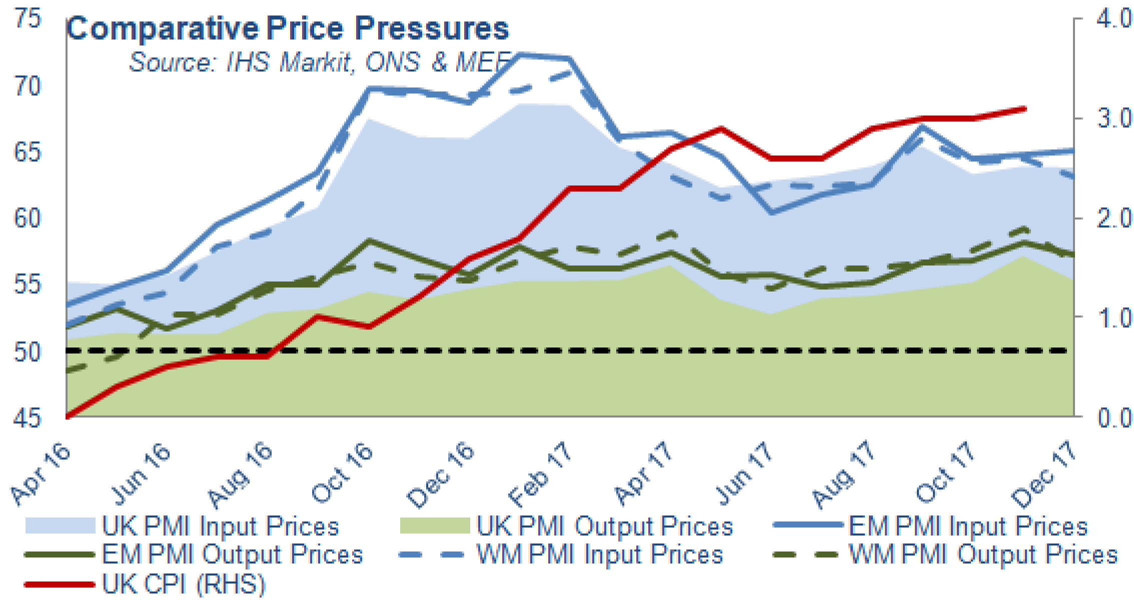
Julian Beer, Deputy Vice-Chancellor at Birmingham City University commented: "Continued favourable regional economic prospects can be expected to receive further impetus from expenditure associated with the awarding of the 2022 Commonwealth Games to Birmingham. Indeed, medium-term prospects for the Midlands continue to improve given the strengthening of export demand in the region's principal export markets. This optimism however must be set against the news that Wolverhampton-based Carillion has filed for compulsory liquidation."

This output demand was reflected in job creation in the Midlands accelerating from November and rising at the fastest pace in the UK, according to the IHS Markit-REC UK Report on Jobs. However, there was a further decline in the availability of candidates, with many citing skills shortages and geographical challenges; this led to salary rises, in order to attract new candidates. Moreover, the pace of salary inflation was the lowest in the Midlands out of all of the UK regions.

Similarly, the Midlands PMIs recorded growth in employment demand across manufacturing and services firms in the region; although there was some softening in December from November, labour demand in the region remained broadly in line with national levels. This reflected increased new business and output in both EM and WM, and, despite growth in employment, backlogs of work still increased in the region at a faster pace than the national level of increase.

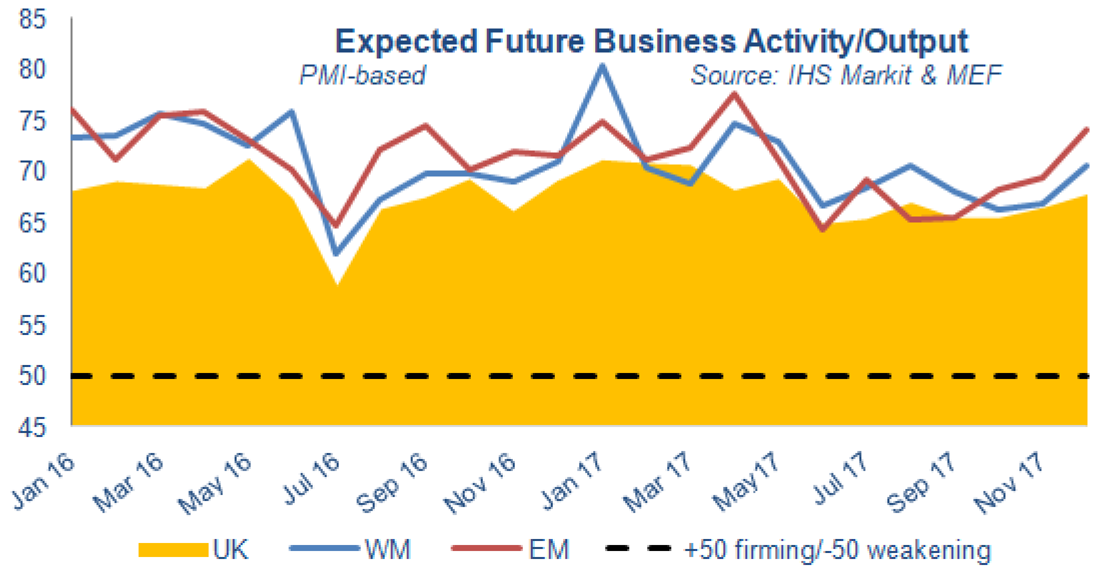


Price pressures in the Midlands eased somewhat in December, although still remained acute. Input prices continued to rise in December, with the pace of increase accelerating from November in the EM. This reflected increased raw material costs – notably steel – as well as the cost of importing inputs. Output prices also continued to rise in order to protect profit margins, although growth was slower than that seen in November.



Rising commodity and utility costs were the main drivers of input price inflation, according to the three sector PMIs, although respondents for the manufacturing PMI also cited the exchange rate as a factor in rising input costs. The rate of input price rises were softer for manufacturers, compared to construction and services firms.

In the Midlands, future business confidence increased further from November in December, and remained above the national levels. Moreover, business optimism in the EM was second highest of all regions measured. Businesses in the Midlands, across both manufacturing and services, cited increased capacity, higher new orders, product development and new sales strategies as reasons for an optimistic outlook.



The picture of business sentiment was mixed across the three national industry PMIs, with manufacturing and services reporting robust levels of confidence, while confidence among construction firms was more subdued. Manufacturers looked to continued growth in demand from foreign and domestic markets, investment in capacity, launching new products and increased market share over the next year, whilst services firms also anticipated stronger demand from robust global economic conditions. In contrast, construction firms were less confident, citing uncertainty from the UK economic outlook and its impact on customer spending.

British markets, and indeed politics, could, however, experience some volatility as the impact of the announcement in the press that the beleaguered construction and services conglomerate Carillion will be liquidated. With leading UK Banks exposed to as much as £900 million in loans, a potential pensions deficit of an estimated £580 million but potentially rising to £800 million, press reports indicated the corporate required some £300 million by the month-end to secure its immediate cash flow. With the British public sector heavily dependent on services provided by Carillion, across a swathe of activities ranging from health, schools, security, defence and transport infrastructure, it is not simply a matter of supporting a bank rescue package, but ensuring the maintenance of essential public services and the employment of 43,000 staff, of which 20,000 are UK based.

In 2016 Carillion reported sales of £5.2 billion, and prior to reporting loses of 1.15 billion last year, as of July 2017 it had a market capitalisation of close to £1 billion, which had fallen to £61 million at the end of last week. Nevertheless, it still has substantive and substantial medium-to-long-term contracts pipeline that should ensure its long-term viability, if its short-term cash flow could be secured. Recent changes to British state procurement policies have had an adverse impact on Carillion's ability to secure future contracts, and this may raise concern regarding similarly structure corporate vehicles. Moreover, it could undermine government fiscal projections on debt as well as bring Britain into conflict with the EU over any support package that breaches state-aid guidelines.

As a key regional corporate, Carillion's HQ based in Wolverhampton, there must also be concern regarding local supply chains, especially of SME sub-contractors many of whom are already reported to be on 120-day terms.

Market sentiment toward Britain has however strengthened on the back of firming economic data and favourable perceptions of recent Brexit negotiations, with £ appreciating to US$1.37 last week, and many forecasters anticipating a range around US$1.50 by year-end. The strength of global economic performance, notably in the EU, USA and PRC, is expected to contribute to sustained British export growth over 2018, notwithstanding the recent and forecast erosion of international competitiveness. However, sentiment remains vulnerable to market evaluations of the extent of progress toward a conclusion of Brexit negotiations between Britain and the EU by October. Coupled with rising global oil prices, Brent hitting recent highs of US$70pb, potentially reviving price pressures, expectations of monetary policy tightening in Britain could increase, enhancing £ attractiveness.

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Notes to the Editor:

Birmingham City University: Centre for Brexit Studies

The Centre for Brexit Studies (CBS) is an academic facility which supports and encourages the existing work on Brexit within Birmingham City University's schools and faculties. It promotes rigorous engagement with the multifaceted aspects of the "Leave" and "Remain" perspectives in order to enhance understanding of the consequences of withdrawing from the EU. Whilst CBS will have a national focus we will also specifically investigate the impact on Birmingham and the surrounding areas. The work of CBS is primarily undertaken by Birmingham City University staff and students, but we will provide collaborative opportunities with interested businesses, professional organisations and civil society. Our work will be accessible to the general public and we will hold conferences, workshops and seminars to disseminate knowledge and encourage discussion on Brexit. The Centre website will also reference member's publications on Brexit issues.

The last month has seen the Centre consolidate and expand its activities, with a view to making a continued contribution to debate and thought leadership on the subject, with a research examining the potential for trade with Commonwealth countries, employment law implications and future humanitarian relief (particularly in light of recent natural disasters in the Americas) . Forthcoming work will include further analysis on potential future trade links with Commonwealth countries, particularly focussing on India, Australia and Nigeria. In addition, the Centre plans to enhance its communications capabilities and web presence with a series of regular podcasts by academic experts. The "CBS" roadshow planned for November and December will take us across the country in an effort to identify and understand people's current concerns around the Brexit process and what it means for them. Finally, an early "heads up" for the CBS Annual Conference next March, where we can confirm keynote speakers including Professor Patrick Minford of Cardiff University, and Professor Vernon Bogdanor FBA CBE of Gresham College.

Midlands Economic Forum:

The Midlands Economic Forum is a neutral, independent forum bringing together representatives of the public, private and voluntary sectors to evaluate real trends in the local economy. Midlands Economic Forum is part of the West Midlands Economic Forum Group.