Regional Monitor February 2018

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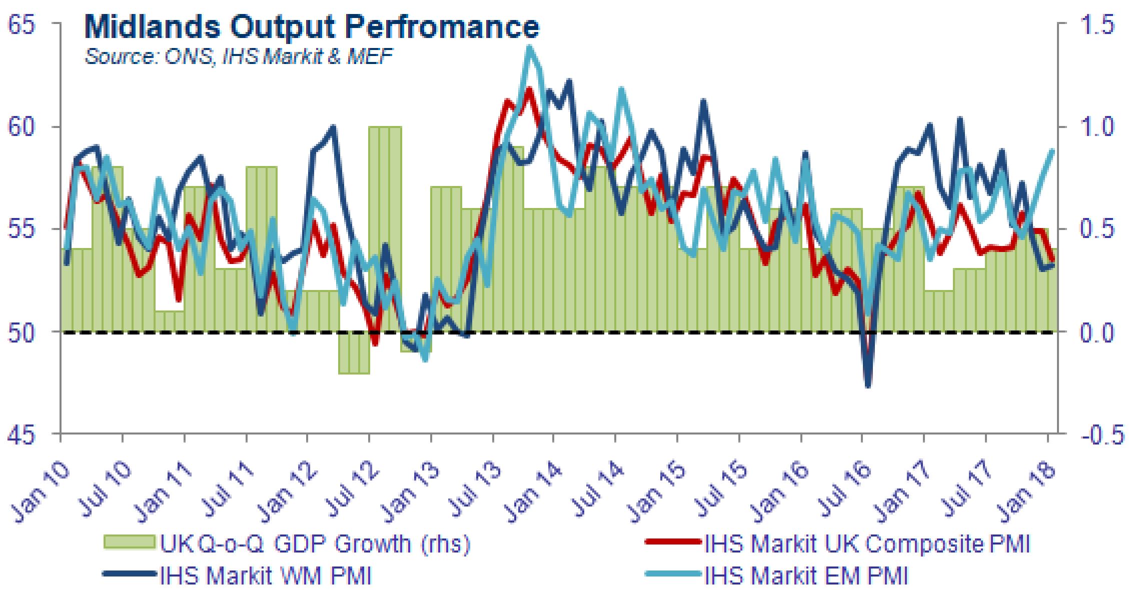
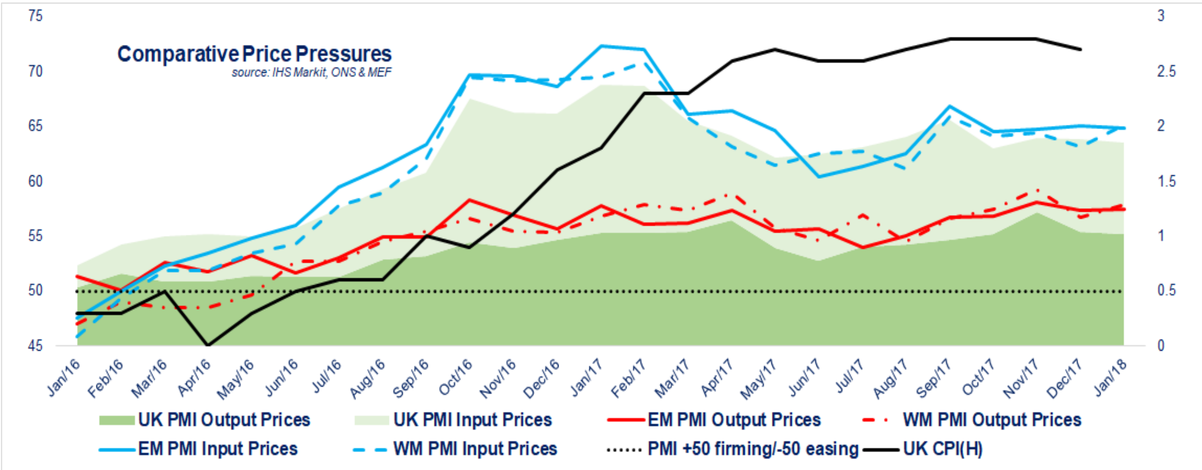
Latest Global Trends, Regional PMI, Output Data, Trade Conditions & Brexit Update

Days since Article 50 activation: 320 **Conclusion of Negotiations October 2018**

- EM strongest performer nationally, the PMI rising from 57.5 in December, to 58.8 in January this year, the fastest acceleration in 3.5 years.
- WM performance improves marginally from 53 to 53.2 in January, but still registering firm growth prospects.
- Inflationary pressures, now both in terms of input and output prices, continue to remain robust.
- Carillion and easing automotive sales, as well as global market volatility yet to feed through into regional performance, with demand for regional output strong both domestically and internationally.
- Impact of Brexit on regional economic growth remains problematic to predict.



The EM was the strongest performer according to this month's IHS Markit regional PMIs, with the indicator accelerating to 58.8 in January, from 57.5 previously – the sharpest increase in output recorded in three-and-a-half years. In contrast, activity in the WM was more subdued, improving modestly from 53.0 in December to 53.2 in January. Nevertheless, both readings were indicative of further and increasing growth, whereas overall English performance was declining due to the drag of the underperforming London and the South East regions, and that of the UK was also recorded slipping as result of continued marginal performance in Scotland. Nevertheless, all regions recorded increases in private sector employment as well as heightened price pressures as input prices continued to increase, notwithstanding some moderation of £ depreciation against the US$.



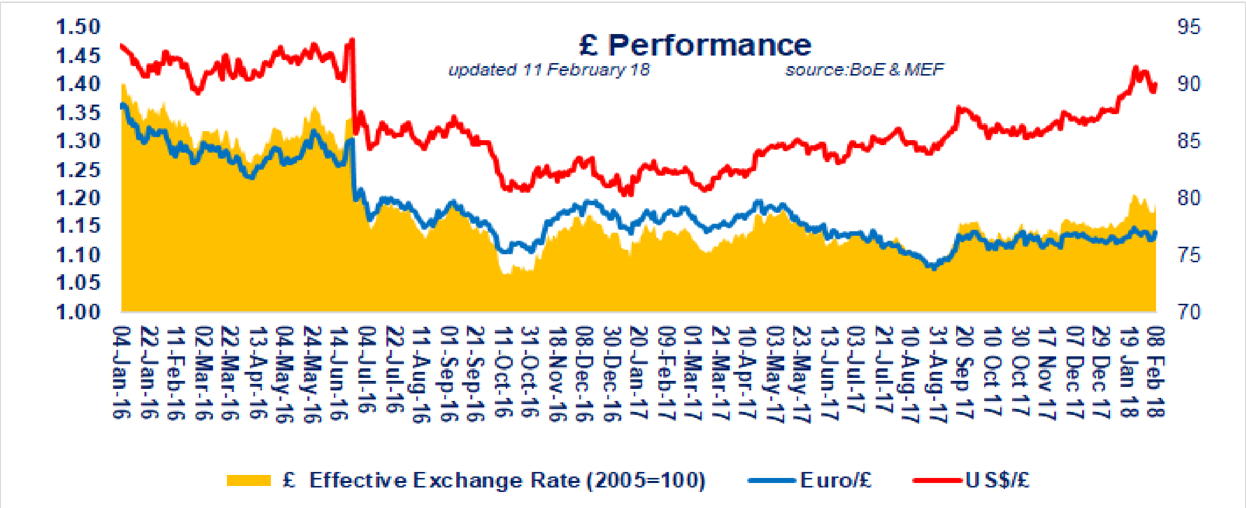
Whilst the rate of price acceleration has to some extent moderated in the EM and WM in recent data, it remains, and indeed is being sustained, at an elevated level, as does the national CPI - which at 3% remains on the edge of the acceptable bounds set for the BoE by the Treasury. The slight slackening of input price pressures may in part be as a result of the relative appreciation of £ against the US$.

EM enterprises indicated that average input prices in January rose again, representing a period of rising inflationary pressure dating back to March 2016. However, the principal factors attributed for these pressures, currency depreciation and commodity prices do appear to be moderating, although given current global market volatility discerning trends is problematic. It is now apparent that prices charged by both manufacturing and service enterprises are increasing at a rate greater than that levied previously. A similar pattern of price pressures was evident in the WM, although inflationary prices were firmer as prices reached a four-month high. It was also apparent that WM manufacturers were experiencing greater price pressures than services enterprises. Whilst in terms of national performance, WM prices were recorded to be the third fastest rate.

On a more positive note, output activity in both the EM and WM continued to increase, notwithstanding national data indicating weakening performance in the automotive sector and the as yet unquantified impact of Carillion. In the WM, the current period of expansion has now extended to 18 months and appears to be firming - although again at a slower rate than that recorded nationally. High demand was reflected in the levels of new business. In the EM the period of expansion extends back to January 2013, reflecting perhaps the strength of demand for aerospace components. Strong demand nevertheless was recorded from both domestic and international clients.

Julian Beer, Deputy Vice-Chancellor at Birmingham City University commented: "The latest regional PMI data continues to indicate that the Midlands economy remains on a growth trajectory, notably in the East Midlands where output accelerated at the end of last year. With firming growth in key export markets prospects for 2018 remain positive notwithstanding continued uncertainty with regards to Brexit. With negotiations currently intended to conclude by October, the shape of Brexit should become more apparent in the forthcoming months".

The apparent resilience of the Midlands economy takes place against a continuing backdrop of stronger global economic performance. However, this revived performance appears to have triggered heightened volatility in global financial markets, with stock markets experiencing substantial gyrations. Notably, rising US wage costs seem to have stimulated concern that global prices are set on an upward trajectory, with monetary policy expected to tighten as a result, following an extended period of almost or actual negative real rates, coupled with quantative easing, from which both asset classes and stock markets have benefited. As monetary policy returns to more "historic" norms, global capital markets will undoubtedly need to adjust, but whether the current correction turns into something more profound, a decade after the previous global financial crash, is of concern.



The £ has benefited from weaker sentiment toward the US$, as the Federal authorities struggled to secure passage of their budget, despite stronger US growth prospects. Nevertheless, market sentiment toward £ remains vulnerable to the perception of adverse developments in the ongoing Brexit negotiations. With Brexit negotiations due to be concluded by October this year, with or without a transition/implementation period, the currency may become subject to increasing speculative attacks. However, against both the US$ and particularly €, as well as in effective exchange rate terms, £ has remained relatively stable following the precipitous fall in the quarter after the 2016 referendum – a factor that seems to have benefitted exporters.

Rumoured Government Brexit Assessment

assumed forecast impact on economic growth over 15 years compared to current forecasts

Region	Single market	Free trade	No deal
East Midlands	-1.80%	-5%	-8.50%
West Midlands	-2.50%	-8%	-13%
United Kingdom	-2%	-5%	-8%

source:BBC

With the Prime Minister not due to reveal her Brexit strategy for some weeks, there is much speculation as to the potential economic impact. Although the Prime Minister continues to categorically reiterate that Brexit means leaving both the single market and customs union, what form the future British-EU interaction will take has yet to be articulated. It is therefore difficult, if not premature, to forecast future impacts, although leaked government papers, whose status is not clear, indicate that within the civil service there may be considerable pessimism. Over a 15-year period, a No Deal, worst case scenario the impact is quantified as compressing potential growth by 8% nationally, and by 13% in the WM and 8.5% in the EM.

Moreover, given the means by which these forecasts have been placed in public domain, it is not clear if these forecasts are the cumulative or annual impact assessment. If they assumed to be cumulative, then over the forecast 15-year period, the annual average impact appears to have been estimated as less than 1%, even with the most pessimistic of outcomes. Whilst none of these is a favourable outcome, and Brexit is unequivocally not without costs, an accommodative policy response could conceivably offset the impact of Brexit, by realising new opportunities that may become available.

Rumoured Government Brexit Assessment

assumed forecast impact on annual economic growth over 15 years compared to current forecasts (%)

Region	Single market	Free trade	No deal
East Midlands	-0.12%	-0.33%	-0.57%
West Midlands	-0.17%	-0.53%	-0.87%
United Kingdom	-0.13%	-0.33%	-0.53%

source: BBC & WMEF

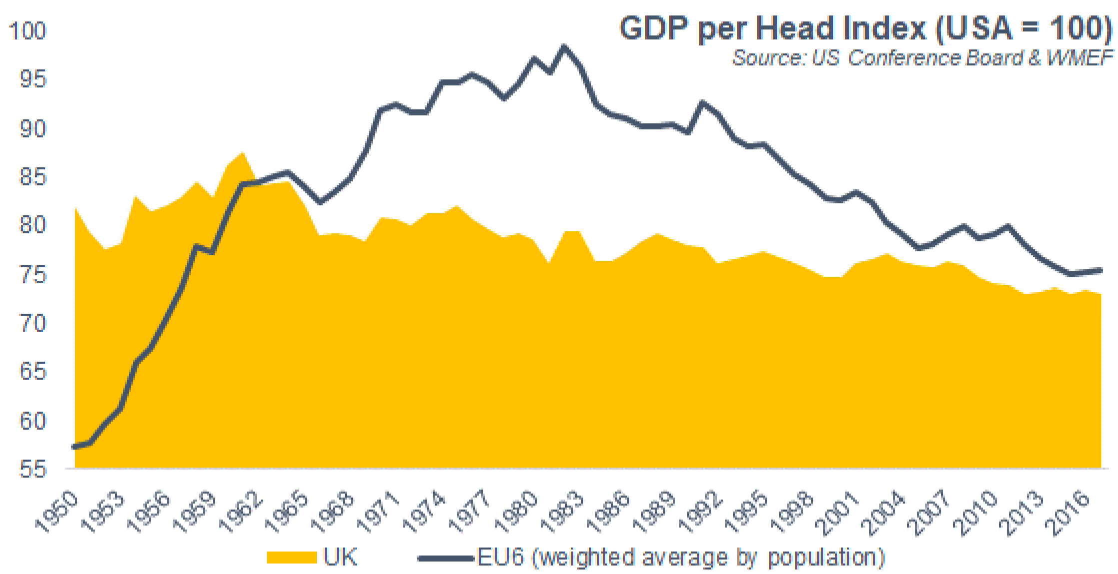
Nevertheless, these figures are substantially greater than those for London (1% hit remaining in the single market, 2% with a free trade deal and 3.5% under WTO rules). As the Government have not released the detailed papers to the public it is not possible to critique the methodology as we do not know how the results were arrived at. Although most academic analysis suggests that the regions which voted most strongly for Brexit are likely to be hardest hit, this is largely driven by the size of the manufacturing sector (which trades considerably more heavily than the services sector).

In any event, whilst the overall figures of the latest Government analysis are broadly in line with previous estimates of the impact of Brexit upon the UK economy as a whole (and it is important to emphasise that there is considerable academic consensus that this impact is likely to be negative), any such analyses are, inevitably, estimates. It is unclear, for example, what agreement may be reached relating to financial services (which is particularly important for London but much less so elsewhere). In addition, Brexit poses a number of critical questions over labour supply (particularly skilled labour from the EU), none of which standard trade analyses address. It is also unclear what impact a substantial Sterling depreciation would have: it is not realistic to posit that Brexit would lead to a large, permanent increase in the UK's trade deficit.

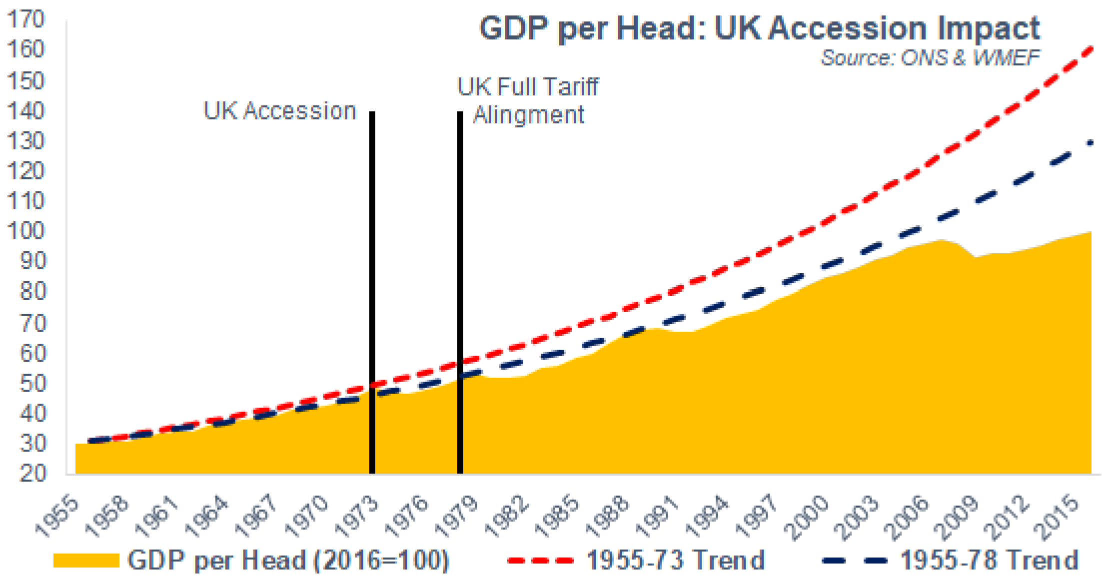
Finally, good technical analysis is challenging. Whilst, with a few notable exceptions, most such analysis has suggested that Brexit is likely to have a negative overall effect on the UK economy (relative to a continuation of the status quo), there is no consensus over the size of such an effect. Analysis on a sub-national level is considerably more difficult again, in part due to data limitations. This necessitates difficult methodological choices over one's modelling strategy and attempts to "fill in the blanks" that have been left by a lack of data. Each of these involve trade-offs and none are perfect. Only if the Government chooses to release these impact assessments in their entirety can we assess their modelling choices and comment on the extent to which they are likely to appertain to the post-Brexit scenarios we may face. In the absence of this only one verdict is possible: unproven.

It is noticeable that the worst-case scenario is substantially less that the estimated cumulative impact of the 2007-09 financial crisis, which has been calculated an equivalent to a loss of a fifth of GDP. It had been previously forecast that by 2022, GDP would be approximately 27% higher than 2007, whereas as current forecasts suggest by 2022 it may only be 8% higher than 2007.

Over the forecast 15-year period, the annual impact appears to have been estimated as less than 1%, even with the most pessimistic of outcomes. Whilst none of these is a favourable outcome, and Brexit is unequivocally not without costs, an accommodative policy response could conceivably offset the impact of Brexit, by realising new opportunities that may become available.



Research by the Centre for Business Research, Cambridge University, suggests that the ultimate impact of Brexit may prove less profound than many current pessimistic forecasts indicate. In part this is as a result that any economic analysis is based on behavioural assumptions that may or may not prove correct. One such assumption is that there was a marked improvement in British economic performance once it became a member of the then EEC and now EU. Measured in GDP per capita terms as proportion of US GDP per capita, there does not appear to have been a noticeable transformation of British performance. Indeed, in terms of the original 6 member states, measured in per capita GDP there seems to be a marked deterioration in performance.



Plotting impacts against trends, especially if they are long-term, is extremely problematic, as stated above. There are many variables or episodes that can fundamentally shift the structure and performance of an economy. However, taking the trend rate of growth from 1955 until EEC accession (1973) or full tariff alignment (1978), the impact of membership of either the EEC or EU does not appear to have had a transformative impact on the British economy.

This is not to say that membership has not had a beneficial impact, and indeed as a political economic construct the EU membership can been seen to have been wide ranging, but measured economically in GDP per capita terms the assumption has yet to be proven. However, equally so, many of the modern constructs of the EU only came into place in the 1990s, such as the Single Market (and subsequent increase in membership) so comparisons with the point of UK entry in 1973 need to be taken with caution.

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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. Current work includes further analysis on potential future trade links with Commonwealth countries, particularly focussing on India, Australia and Nigeria. In addition, the Centre has enhanced its communications capabilities and web presence with a series of regular podcasts by academic experts. The "CBS" roadshow is currently taking 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, a "friendly reminder for the CBS Annual Conference next month (March 16th – 17th), where we can confirm keynote speakers including Professor Patrick Minford of Cardiff University, Professor Vernon Bogdanor FBA CBE of Gresham College and MPs Anna Soubry and Bernard Jenkin.

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.