BIRMINGHAM CITY University Centre for Brexit Studies

MIDLANDS ECONOMIC FORUM

Regional Monitor May 2018

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

Days since Article 50 activation: 410 ***Conclusion of Negotiations October 2018***

- EM PMI softens to 54.3 in April from 55.2 in March, WM PMI increases to 54.8 from 53.0 previously.

- Growth in the three national sector PMIs remains softer, although construction and services growth recovered from March.

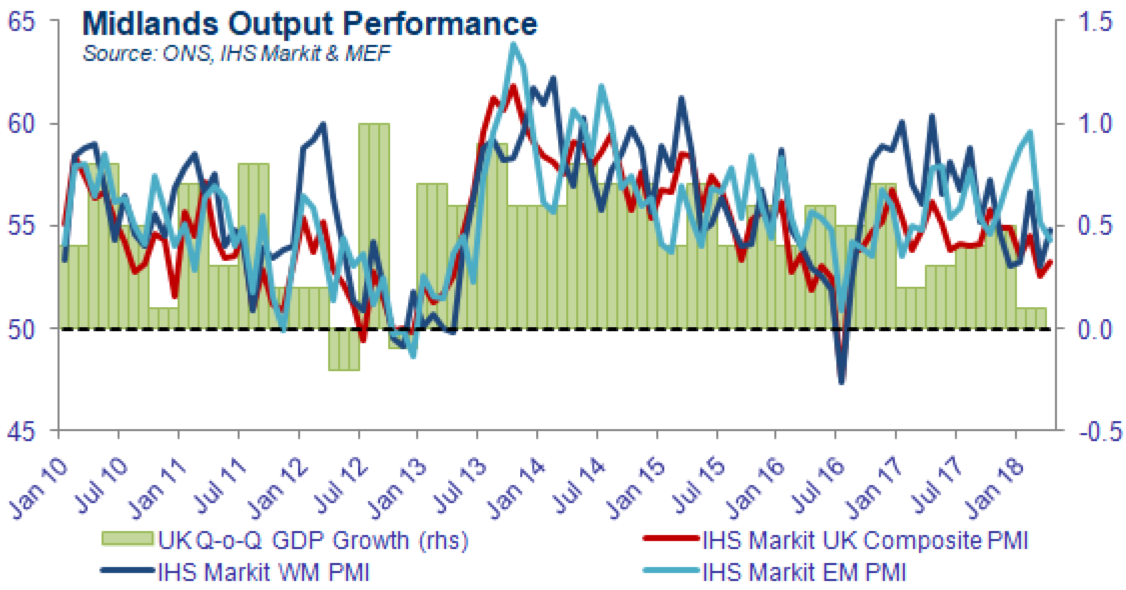
- Price inflation softened across the Midlands and the UK, although new Living Wage and pension contributions put pressure on business margins.

- Job creation in the Midlands continues to outpace that of the UK overall, but is slowed by tight labour market conditions and skills shortages.

- Business optimism rebounds slightly in April, although economic and Brexit-related uncertainties remain.

- Brexit: The House of Lords' recently voted in favour of retaining membership of the European Economic Area and Customs Union post-Brexit, raising fresh doubts on the Government's approach.

In the Midlands, the PMI figures for April showed continued growth, with the EM recording 54.3, from 55.2 previously, and growth in the WM rising from 53.0 in March to 54.8. The UK composite PMI was 53.2 in April, from 52.5, meaning that growth in the Midlands outperformed that of the UK overall. Growth in the Midlands was attributed to an increase in new business, as well as increases in demand following March's poor weather. However, concerns about subdued demand within the automotive sector were expressed by some manufacturers. Staff retrenchment at JLR, coupled with government advocacy of electric engines, and the continued fall-out from Carillion, however has put a dampener on future prospects. Similarly, the sharp fall (y-o-y) in retail footfall recorded across retail parks, high street and shopping centres, down 4.7% in the WM and 2.8% in EM in April, not only highlight the apparent sector restructuring taking place, but also the need to have a comprehensive regional economic and industry strategy.



These growth trends were reflected in the three UK sector PMIs, with slightly slower growth in manufacturing, and a recovery in growth from March in the construction and services sectors. Manufacturing saw increased new business, although demand for exports was slower and supply chain constraints acted as a brake to growth. Nevertheless, there was still demand from Europe, the USA and Asia, notably for consumer goods.

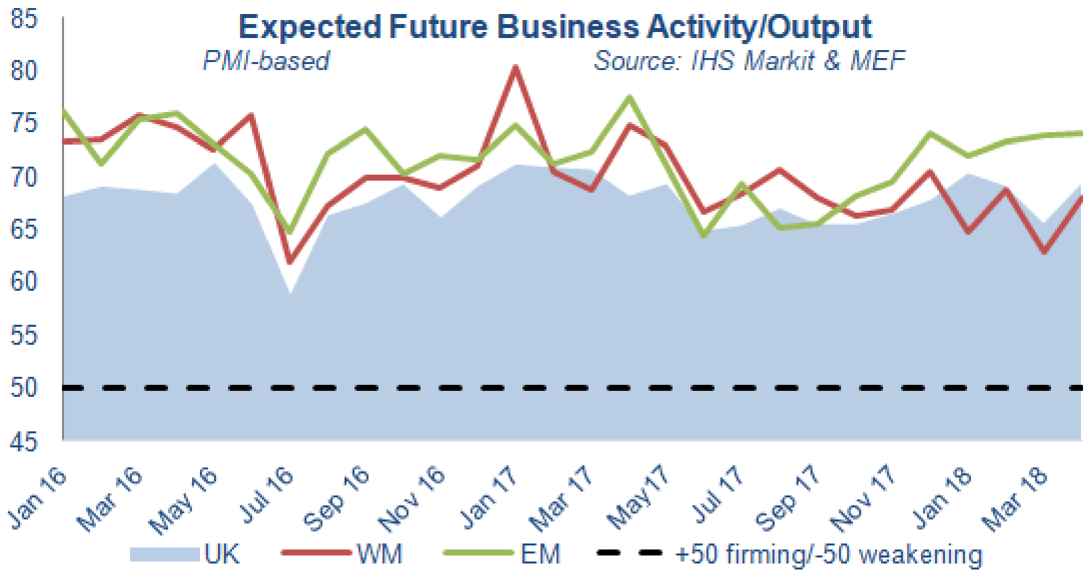
The construction and services sector PMIs both recorded subdued demand due to uncertainty from clients, with the current uncertain economic conditions cited as the main reason for this in both sectors.

***Julian Beer, Deputy Vice-Chancellor at Birmingham City University** commented: "After the poor weather seen in March, growth in the Midlands was firmer in April, with the PMI for both regions higher than that of the UK overall. However, if the current tight labour market conditions continue, with shortages in key skills, then this could act as a brake on growth in the region. Nevertheless, job creation in the Midlands outpaces that of the UK, a sign that the Midlands is one of the UK's strongest regional economies."*

Despite the subdued growth, permanent placements in the Midlands continued to grow, according to the IHS Markit - REC Report on Jobs, with the growth rate outstripping that of the UK overall. Given the levels of demand, the pool of candidates continued to shrink in the Midlands, with shortages of both skills and experience cited, and upward pressure was placed on salaries – which was noted as an additional cost burden in the UK services PMI for April. All three UK sector PMIs recorded increases in jobs, although the pace of growth was slower in the services sector, exacerbated by tight labour market conditions. This marginally slower rate of job expansion was seen in the Midlands, although the rate of job expansion remained faster than that of the UK in line with increases in new business. WM businesses also highlighted the tight labour market conditions, higher payroll costs and shortages of skills as reasons for the slower growth in employment.

The ONS index of production was broadly flat in March, rising 0.1% from February, in line with the Q1 GDP figure, within that figure, manufacturing was estimated to have fallen by 0.1% - moreover, unlike the PMI data, the ONS commentary suggests that there was little impact from the adverse weather conditions in March. The Construction Output in the UK index fell 2.7% in Q1 of 2018, following a slight peak in December 2017. Unlike the Index of Production, there is anecdotal evidence that the poor weather conditions affected business output, according to the ONS.

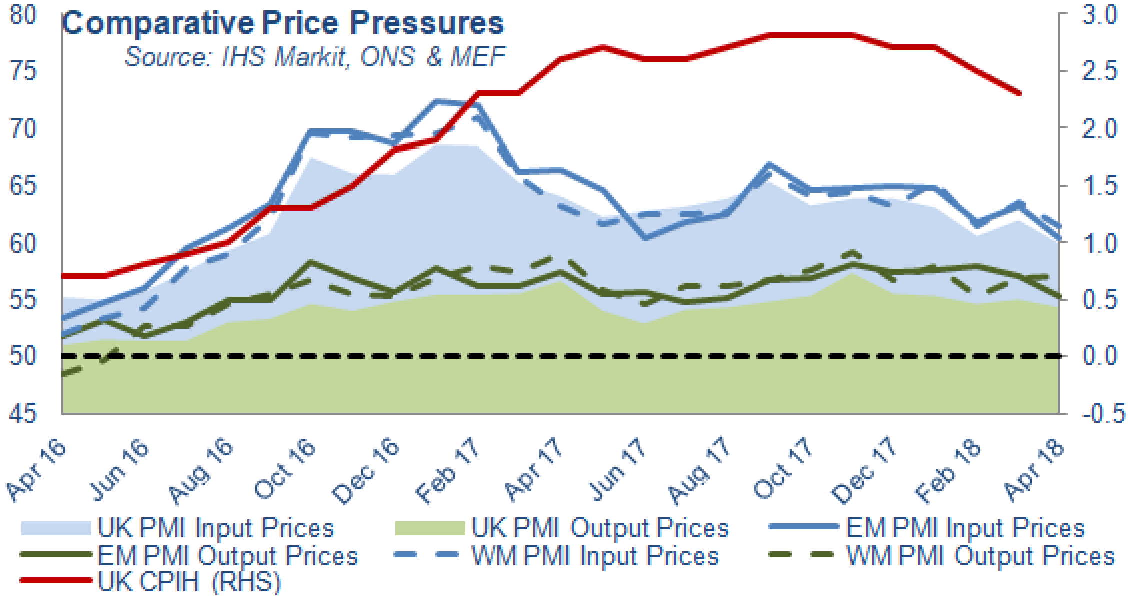
In the Midlands, confidence about the coming 12 months increased in April, although in the WM it was lower than in the UK overall, with Brexit and weaker demand from the automotive and construction sectors cited as reasons for softer confidence levels. Across the Midlands, optimism was linked to strong demand, notably for exports, and new product innovations.



These trends were more mixed in the three UK sector PMIs, with manufacturers experiencing a slight dip in confidence, although construction and services firms saw a slight uptick in levels of optimism.

In the Midlands, both input and output costs continued to rise in April, although the rate of inflation is abating from in 2017. In the WM, the increased value of Sterling mitigated some of the input cost rises, although businesses also noted higher payroll costs and metals prices. In the EM, price rises stemmed from shortages of raw materials due to increased demand.

In terms of output prices, in the WM, output price inflation increased in April, in contrast to the UK, this was due to partially passing on higher payroll costs to clients. In the EM, output price inflation slowed, but firms also cited rises due to passing on additional costs to customers.



This trend was reflected in the three sector PMIs, with levels of input inflation easing in all three surveyed sectors. Raw materials costs were cited as the main reasons for price increases in the manufacturing and services sector, with fuel costs and higher steel prices cited as two examples. In the services sector, labour costs were the main driver of input price inflation, with the introduction of the new national living wage level and increased pension contributions, as well as larger payrolls cited as reasons for cost increases. There was some evidence of these costs being passed on to customers, at least in part.

Consumer price inflation, although remaining above the Bank of England's target of 2%, eased to 2.3% in March from 2.5% in February according to the CPIH measurement. This, along with the slower than expected growth figure for Q1, meant that the monetary policy committee voted to maintain Bank Rates at 0.5% this month. In terms of producer prices, the latest ONS data showed that output price growth moderated to 2.4% in March, from 2.6% in February. The official statistics showed that input price growth increased to 4.2% in March, from 3.8% in February – although it should be noted that these figures are largely dependent on commodity prices, and therefore can be somewhat volatile.

Brexit Update

The House of Lords' recent vote in favour of retaining membership of the European Economic Area (EEA) post-Brexit has thrown open the question of whether the Government can command sufficient support to ensure its vision of Brexit is enacted. In essence, several competing visions have emerged:

- A "Lords' Brexit", entailing continued membership of both the EEA and a customs union with the EU
- An arrangement where the country would leave the EEA but remain in a customs union with the EU and retain similar phytosanitary and goods standards to facilitate trade
- A looser "customs partnership" that remains relatively ill-defined together with a host of other agreements
- A "hard Brexit" that would involve the UK becoming a 3rd country and signing a conventional FTA

The first of these is problematic because it retains a number of features of the EU that those in favour of leaving have vowed to abandon – particularly freedom of movement of labour and the jurisdiction of the Court of Justice of the EU – whilst meaning the UK ceases to have a say in any new rules. In any of the other scenarios, however, the UK faces the problem of needing to renegotiate a host of agreements with the EU. Whilst some of the most serious questions will be raised for the aerospace and haulage sectors, Brexit also throws up questions for sectors such as broadcasting or digital services. Leaving the European Economic Area will also mean that the UK leaves the EU's Digital Single Market.

The EU has however issued guidance for broadcasters and video streaming services, to state that after Brexit 'persons residing in the UK will no longer benefit from their digital content subscriptions when travelling to the EU'. At this stage, this is only guidance, but it is likely that UK residents will feel a material impact in future from leaving the Digital Single Market (and the Audiovisual Media Services Directive ceasing to apply). Transnational Television broadcasts will also be affected. At present this is regulated by the Audiovisual Media Services Directive of 2010. Prior to this was the TV Without Frontiers Directive passed in 1989 and last amended in 2007.

Post-Brexit the UK will default to the European Convention on Transfrontier TV, also passed in 1989, when the UK only had four TV channels. Nothing like the mass of choices we have available today through Freeview, Sky, Virgin and on demand services. Not only could this have a big impact at home, it could also hit British broadcasters who want to make their content available abroad. The UK is one of the largest beneficiaries of the rights conferred by these Directives, perhaps in part due to the popularity of English language broadcasts. At present, UK television companies who are licensed by Ofcom can broadcast into any EU member state, but under current plans after Brexit this will no longer be the case.

Similarly, post-Brexit, the EU agreements allowing reciprocal access for hauliers throughout the EU will automatically cease unless a replacement is negotiated. If this occurs then the UK currently has some 1224 multilateral permits (allowing access throughout the EU and a host of other European countries) under the "European Conference of Ministers of Transport" agreement. These will need to be shared amongst some 75,000 British HGVs that, at present, travel onto the continent unhindered. Bilateral permits allowing British HGVs to travel to other European nations can be negotiated but, crucially, a separate permit would be needed for *each country a lorry wishes to travel through*. The byzantine paperwork involved and likelihood of a shortage of permits is likely to create huge additional delays at ports for exporters. Thus far, no agreement on reciprocal HGV access has been negotiated between the EU and a third party that does not also grant freedom of movement of labour (in part because of the difficulty of avoiding the latter if HGV drivers are freely traversing the border).

These are just two examples of the plethora of agreements that have yet to be negotiated and will be needed outside of the EEA as the countdown to October continues.

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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.

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.