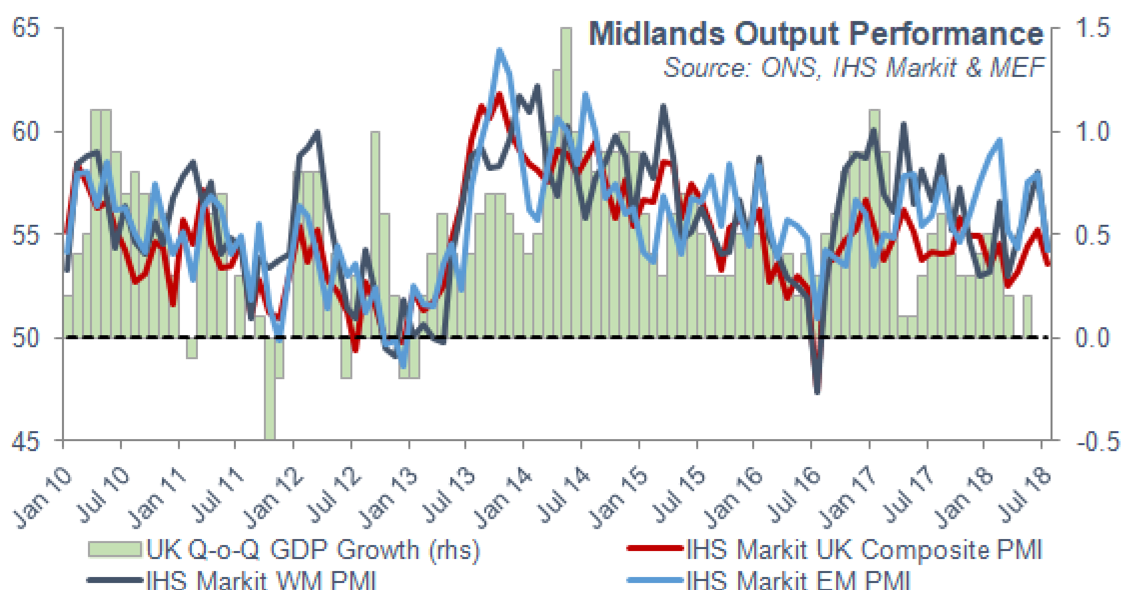
Regional Monitor July 2018

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

Days since Article 50 activation: 501 ***Conclusion of Negotiations October 2018?***

- The NatWest Regional PMI for the EM and WM recorded 54.2 in July, softening from June's highs.
- The UK PMI also softened to 53.6, down from 55.2 previously.
- Price pressures abated in the Midlands, although they remain elevated and above UK levels.
- Optimism in the Midlands dipped in July, with policy concerns weighing on confidence.
- Job creation continued to grow, faster in the Midlands than in the UK overall.
- Global market sentiment unsettled by Turkish Lira collapse and serious fear of financial cross-border contagion.

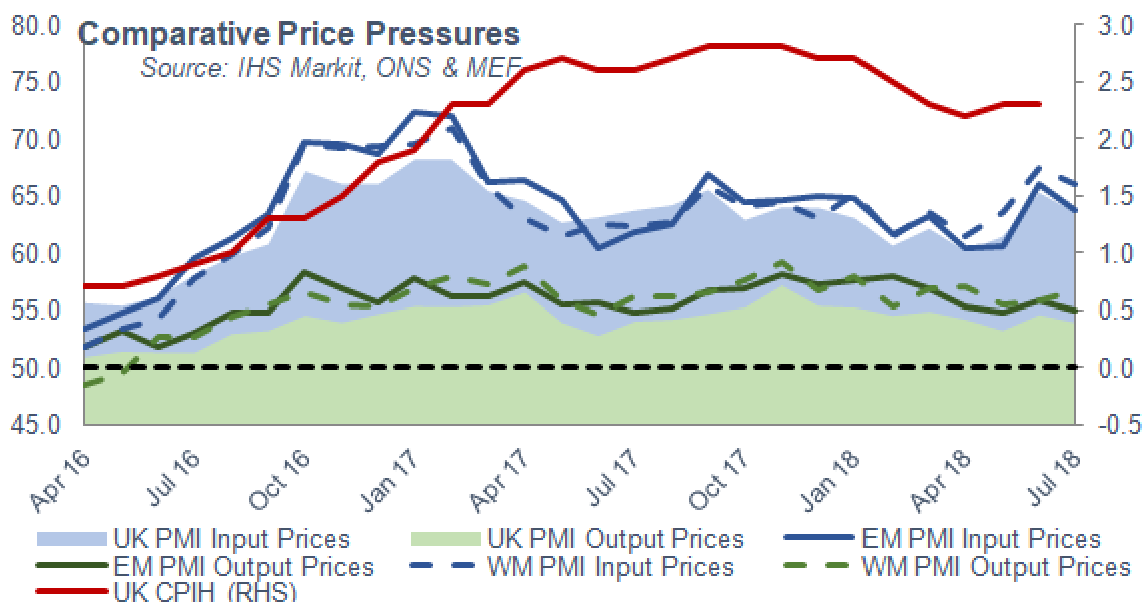
The NatWest Regional PMI showed a slowing in output growth across the region, with the EM and WM both recording 54.2 in July, down from 57.9 in June in the EM, and from 58.0 previously in the WM.



Nevertheless, both regions showed faster growth than the UK average, which was 53.6, down from 55.2 in June. Growth in the Midlands was driven by increased, albeit at a slower pace, levels of new business – especially in manufacturing. This reflects the slightly weaker growth seen in the UK sector PMIs, with manufacturing and services both seeing a softening in growth. In contrast, construction saw a sharp uptick in July. Manufacturing saw increased demand from export markets, offsetting weaker domestic demand, with the good weather boosting some service sector firms, although the disruption of the World Cup may have offset some of this.

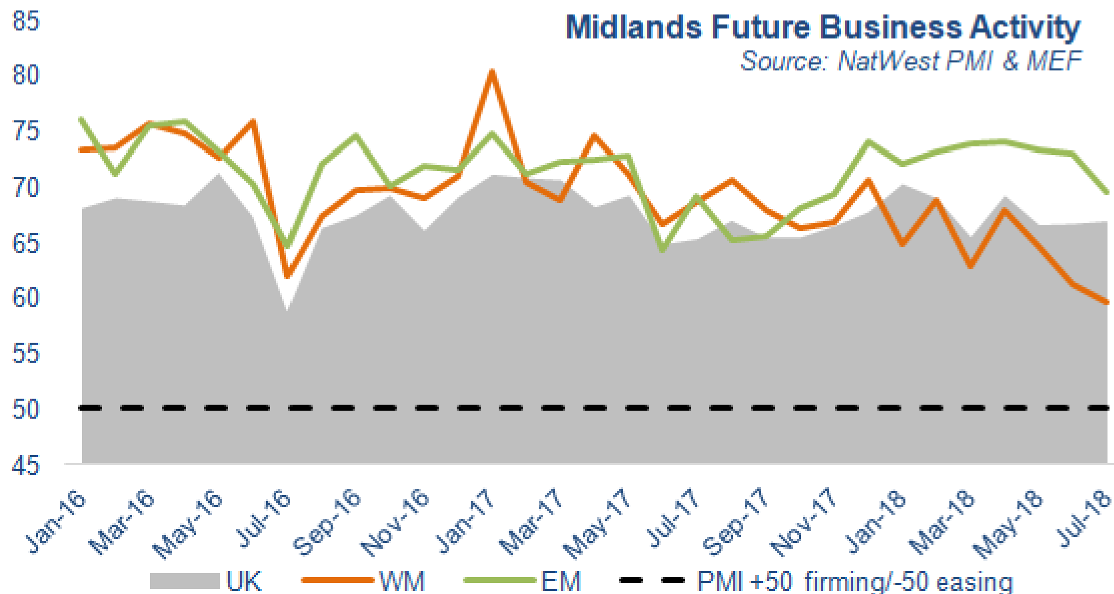
Julian Beer, Deputy Vice Chancellor at Birmingham City University*, commented “As uncertainty about the Brexit process and the broader economic outlook continues, it is positive to see that the Midlands continues to show robust levels of growth and resilience.”*

Price Pressures in the Midlands continued, although they abated from the levels seen in June. Input price increases were attributed to Sterling weakness, higher staffing costs and increased raw material prices, especially fuel, steel and electronic goods. This was passed on to clients in the form of higher prices charged, although this was seen more in manufacturing than in services.



There was a more mixed picture across the three sector PMIs, with services and construction seeing softening rises in price pressures – although still elevated – but manufacturers seeing further tightening. Services providers saw increased staffing costs, while construction and manufacturing firms saw rises in input costs, steel

related products and fuels. Much of these additional costs were passed on to customers.

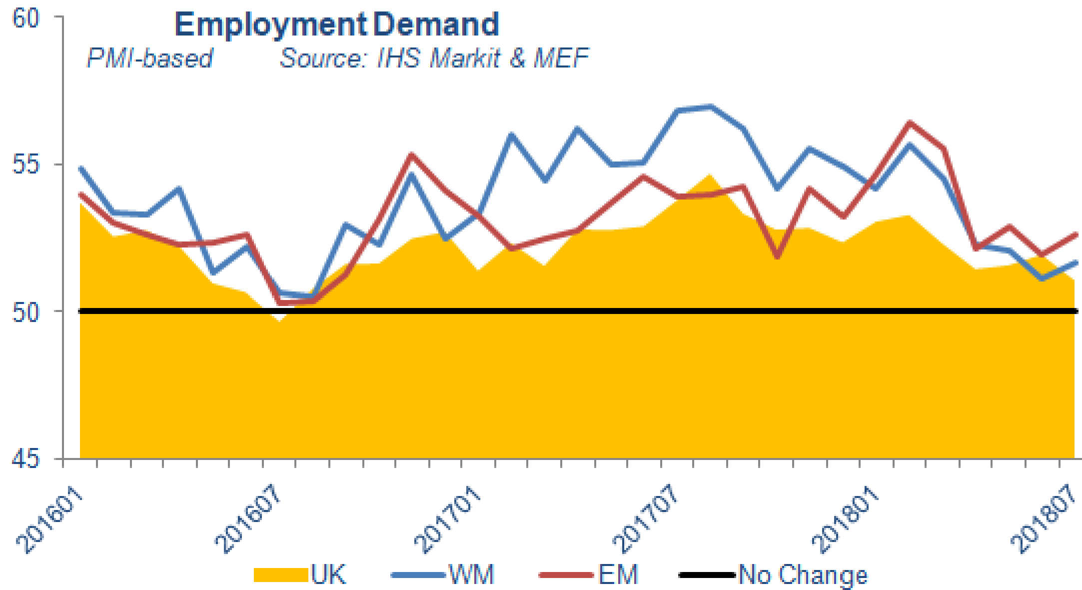


Business confidence in the Midlands dipped in July, although businesses remained optimistic overall. The West Midlands recorded a particular dip, with the second lowest level after Northern Ireland. Some respondents suggested that uncertainty surrounding policy decisions was weighing on confidence.

Concerns around Brexit also weighed on business confidence in the three UK sector PMIs, along with the current economic certainty and, in the case of manufacturing, exchange rate fluctuations.

Despite the lower business confidence levels, employment continued to grow, and at a faster pace than seen in June, in order to meet rising demands. The EM recorded the joint fastest rate of job creation in July, and the WM also saw faster job creation than the UK overall – more so in the manufacturing sector, as services firms reduced their staffing levels.

The three UK sector PMIs also saw growth in employment, the fastest rise since December 2015 in the case of construction, although softening in other sectors. Some services firms highlighted the tight labour market conditions making employment difficult, although others highlighted plans for automation acting as a drag on labour demand.



This trend was reflected in the IHS Markit/REC report on jobs, which showed an overall rise in vacancies, with IT and computing continuing to be the largest area of demand. However, a continued shortage of available candidates led to continued pressure on salaries in July. In the Midlands, there was the fastest acceleration in vacancies of all monitored regions, but also the lowest fall in jobseekers.

The latest ONS data on the regional labour market also noted this trend of labour demand in the Midlands, especially in the WM, where there was the largest increase in workforce jobs, at 64,000, was seen between December 2017 and March 2018. The East Midlands had the largest proportion of jobs in the production sector over the same period, at 13.8% - reflecting the strong presence of manufacturing in the region.

Global Trends

Financial markets volatility intensified as the Turkish Lira plunged further in early Monday trading, and has now lost over 45% against the US$ since the beginning of the year, and by 14% alone in Friday's trading. In the absence of a financial stabilisation package acceptable to the markets, the crisis could widen given the exposure of financial institutions to both Turkish sovereign and corporate debt. Concern that President Erdogan has apparently ruled out hiking interest rates has further weakened international confidence. Banks in Italy (already beleaguered by domestic non-performing loans), Spain and France are seen as particularly exposed and the crisis has seen capital flight from Emerging Markets to safe havens, such as

US$, Swiss Franc and Yen. European currencies, including Sterling, can be expected to come under pressure. Given the scale of international debt owed by Turkish institutions, largely in US$, banks failures, debt defaults and imposition of capital controls cannot be ruled out. The crisis can be seen to be a result of a combination domestic factors; US Fed Reserve monetary tightening and unwinding of QE as well as evident political antagonism between Presidents Erdogan and Trump. Indeed, President Trump's application of punitive tariffs against Turkish exports of aluminium and steel (over the imprisonment of an American Pastor) has exacerbated market tension. How far the EU will, or is obliged to, respond to unilateral sanctions imposed on an EU Customs Union member remains to be seen. Similarly, the very public deterioration in relations between two of NATO's largest military powers opens up the vista of Turkey re-orientating its foreign policy toward the Eurasian one of Russia, Iran and China, rather than its long-standing Atlanticist approach – the protracted rebuff of the EU to Turkey's full membership (an associate member since 1963) is a further factor fuelling mistrust.

Against this worsening global diplomatic backdrop, there is mounting evidence of some softening in the global economy, according to the latest JP Morgan Global Manufacturing and Services PMI. Recent data indicate growth slowing growth in the US, Eurozone, China and Japan, although output in Germany and India accelerated in July. This reflects larger global trends that have been seen recently, including falling prices in many commodity markets. This is perhaps unsurprising, given the escalating trade war between the USA and China, as well as the threat of tariffs hitting Europe and US sanctions on Russia.

Further destabilising factors include the upcoming budget from Italy's coalition government which has raised concerns over the fiscal position of the government, as well as the perceived increased likelihood of a disorderly Brexit causing Sterling to weaken. However, despite this easing of global economic prospects, many central banks have decided to raise rates, with the Bank of England raising the base rate 25 basis points at the beginning of the month, and the European Central Bank set to end its bond-buying scheme.

CBS Brexit Update

The summer parliamentary recess is now upon the nation and hence, in terms of "negotiating" Brexit, one is now seeing the PM and Cabinet members visiting EU capitals. This is being done ostensibly in order to "go over the Commission's head" as it were and appeal directly to national leaders to pressure the EU Commission into adopting a more "flexible approach" to the Government's Chequers White Paper released in the last month.

To recap, the essential elements of this White Paper outlining the Government's "vision" for the future economic relationship with the EU are:

- A desire for a customs "partnership" with the EU (which in effect would mean the UK Government would collect customs revenue on behalf of the EU)
- Access to the Single Market for goods and agriculture only with a "Common Rule Book" (excluding the other "freedoms of movement" for capital, services and most notably – people)
- A bespoke arrangement on financial services, so as to continue "passporting" rights for UK banks into Europe

Suffice to say, the EU response to these proposals has been withering. The proposal that the UK collect customs duties on behalf of the EU is particularly problematic given the UK Government's continued refusal to accept European Court of Justice jurisdiction in the event of any dispute. Any progress to even discussing a future relationship and securing a "transition period" after Brexit next year will of course be contingent on resolving the Northern Ireland border issue.

Thus, it is expected that the Chequers proposals will be rejected at a crunch meeting of EU country ministers in October – hence the current flurry of diplomatic activity from No. 10 and entourage. However, there is no evidence to suggest that any EU country will break ranks with Michel Barnier's negotiating team. Indeed, given that Barnier's brief is set by the other 27 EU member states, it is highly unlikely that there will be, and so it is puzzling that the UK Government's approach is to consume yet more time by seeking to exploit non-existent divisions.

This only betrays a more fundamental concern – that the UK Government is incapable of, or unwilling, to recognise the fundamental principles that the EU negotiating position is based on. As such, a withdrawal agreement by October this year is all but dead-in-the-water, and even December looks optimistic. It is also

alarmingly clear that the Government will not be able to secure a majority in Parliament for any kind of Brexit deal. As such, the PM's own position continues to be threatened by the potential of a no-confidence vote, should either the Brexiter or Remainer wings of her party force the issue.

This leaves talk of a "second referendum" as the only way to resolve what increasingly looks like deadlock. That this in itself would consume time would mean in all likelihood that the Government (if it were so-minded) would have to request an extension to the Article 50 negotiating period, and that the EU (and by definition all member countries) would have to agree to this.

Calls for a second referendum on the terms of the UK's exit from the EU have grown in intensity in recent months. Whilst the original referendum on leaving the EU was legally non-binding, the result has been taken to be politically binding by both Government and Opposition. This is particularly interesting in light of the fact that its non-binding nature was one of the reasons why the referendum was structured in the way that it was.

The fact that many of those who agitate in favour of a second referendum wish to remain part of the EU has led many to believe that this is "sour grapes" from those who lost the first one. For those who voted Leave, another referendum is seen as a plot to thwart Brexit.

The truth or otherwise of this position, however, does not make a second referendum a bad idea. Specifically, there is a reasonable argument that a matter of such vast economic, constitutional and political importance as the nature of Britain's exit from the EU should itself be subject to a referendum, particularly given the lack of agreement amongst the executive and legislative authorities over which direction to travel. However, it is by no means clear that such a vote would generate a decisive outcome, as polls to date have indicated that the country is still deeply divided on the issue.

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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.

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