

# **North West Brexit Monitor**

Key economic and policy developments

January 2018

# Executive Summary

## Headlines

- **EU leaders have confirmed that “sufficient progress” has been made in the first phase of Britain’s Brexit talks, setting the way for stage 2 of negotiations to begin which will focus on the UK’s future relationship outside the EU.** Britain has committed to paying a net exit bill of at least €40bn-€45bn and to a two-year transition deal, and the EU’s Chief Negotiator, Michel Barnier, has stated that the transition has to take place under all existing rules and regulations (including budget payments, the jurisdiction of the European Court of Justice and the free movement of people), and that the transition should come to an end on 31 December 2020.
- **This positive development in negotiations, however, has come against a backdrop of increased economic uncertainty,** with key indicators continuing to provide mixed signals. UK GDP expanded by 0.4% in Q3 (July to Sept) 2017, and while this marked a slight improvement on the 0.3% growth posted in Q2, growth in the UK continued to lag behind the European Union (which grew by 0.6% in Q3) and the group of Euro Area countries (which grew by 0.7%). The UK was one of the fastest growing advanced economies in 2016, but dropped below all other G7 economies in 2017 and is expected to remain towards the back of the pack in 2018, with the Office for Budget Responsibility forecasting 1.5 per cent growth for 2017 and 1.4 per cent for 2018.
- This forecast is echoed by the IMF following the recent conclusion of their Article IV mission. The IMF highlighted that Britain’s vote to leave the EU has weakened the UK economy, downgrading their projection for the UK economy in 2017 from 1.7% to 1.6%, and projecting around 1.5% growth in 2018. **The IMF’s recent mission included a meeting with Cities in the UK to discuss regional productivity differences.** In their concluding statement the IMF highlighted the importance of addressing congestion and housing restrictions, increasing human capital, and improving transport connectivity to boosting regional productivity. The IMF also suggested that **a greater role for local decision-making has the potential to better tailor policies to economic conditions.**

## Key sectors & business investment

- According to the **Lloyds Bank Regional Purchasing Managers' Index** (PMI), growth in business activity fell slightly the North West in November 2017, with the PMI dropping from 57.9 in October to 55.7 (above 50 = growth). However It has since risen in December to its highest level in over three years (58.5). This places the North West as the best performing region in the UK, marginally overtaking Wales (58.3).
- **The IHS Markit/CIPS UK Manufacturing PMI® was 56.3 in December, down from November’s 51-month high of 58.2.** The headline PMI for the sector has remained above the 50.0 no-change mark for 17 consecutive months. Although December saw rates of expansion in output, new orders and employment slowed from November’s highs, whilst growth in all three remained solid and above long-run trend. Part of the increase in new business at UK manufacturers reflected a solid increase in new export sales.
- **The IHS Markit/CIPS UK Services PMI® was 54.2 in December, up from 53.8 in November.** New business volumes increased at a solid pace, but the latest upturn was the slowest recorded since August 2016. Reports from survey respondents suggested that subdued business investment and cost consciousness among clients were factors that had weighed on sales growth in December. Job creation was the lowest in 9 months and input inflation hit a 3-month high, with rising fuel prices, utility bills, and salary payments.

# Executive summary

## Terms of trade, regulation & access to funding

- In a summit in Brussels on December 15, EU leaders endorsed the European Commission's recommendation that the British government had given enough guarantees on the three key divorce issues of the Brexit bill – the financial settlement, the rights of EU citizens, and the Northern Irish border – to begin talks on its future relationship with the bloc. As a result, the EU has published its guidelines for the next stage of negotiations, covering negotiations, transition, law and regulation, and trade policy.
- In response to this, a number of commentators have begun analysing some of the potential key issues for stage 2 of negotiations, discussing the future of EU Structural Funds, cross-border movement of goods and labour, immigration policy (in particular for different regions of the UK), and international export markets.

## Property investment, housing and planning

- **Housing data from the Land Registry continues to show that the vote to leave the EU has had little impact on house prices**, with average house prices in the North West rising by 3.8% on the level recorded in July 2016.
- **Commercial property:** This month's Monitor looks at demand in the big shed market in the North West. The latest Big Shed Report from **Savills** has described 2016 as being "a healthy year for the market", while noting that despite the North West having the highest amount of available space of all the regions in the UK, 75% of the units available are either of Grade B or C quality.

## Economic inclusion

- **Total claimant count unemployment in the North West declined by 1.7% in November 2017 (latest) compared to October 2017 to 109,670 a 9-month low. However this remains higher than one year previous (103,140 in November 2016), and 4.0% higher than June 2016.**
- December data revealed a sustained squeeze on UK household finances, driven by another sharp rise in living costs and corresponding decline in cash available to spend. **The seasonally adjusted Household Finance Index (HFI) – which tracks Britons' sense of financial wellbeing – registered 43.9 in December**, and while this is a slight improvement from November's 43.5, it remained below 50, signalling a deterioration. Moreover, December data revealed that inflation expectations were at their highest since February 2014.
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# Macro-economic trends and developments

## Macro-economy

- **Second estimates of UK GDP remained unrevised from preliminary estimates, suggesting that economic activity expanded by 0.4% in Q3 (July to Sept) 2017 to mark a slight improvement on the 0.3% growth posted in Q2.** Services remained the strongest contributor to UK GDP growth in Q3 2017, expanding by 1.4%, while the rate of growth in household final consumption expenditure strengthened to 0.6%, helping to offset a slowdown in business investment growth, which softened to 0.2%.<sup>(1)</sup>
- **However, growth in the UK continued to lag behind the European Union** (which grew by 0.6% in Q3) and the group of Euro Area countries (which grew by 0.7%).<sup>(1)</sup> The UK was one of the fastest growing advanced economies in 2016 but dropped below all other G7 economies in 2017 and is expected to remain towards the back of the pack in 2018 – along with Japan and Italy – with the Office for Budget Responsibility forecasting 1.5% growth for 2017 and 1.4% for 2018.<sup>(2)</sup>
- **The total UK trade (goods and services) deficit including erratic commodities narrowed by £2.7 billion to £5.0 billion in the three months to October 2017,** due mainly to a narrowing of the trade in goods deficit with non-EU countries. **However, excluding erratic commodities** (which includes non-monetary gold), **the deficit widened by £0.8 billion to £6.9 billion,** due primarily to a decrease in goods imports of crude oil from non-EU countries.<sup>(3)</sup>
- **EU trade: The UK was a net importer from the EU in October 2017, with imports exceeding exports by £8.6 billion.** EU Exports for October 2017 were £14.6 billion, a marginal decrease of 0.3% compared with September 2017, but an increase of £2.0 billion (16%) compared with 12 months ago. EU Imports for October 2017 were £23.1 billion, an increase of £0.6 billion (3%) compared with September 2017, and an increase of £2.6 billion (13%) compared with a year ago.
- **Non-EU trade: The UK was a net importer in October 2017, with imports exceeding exports by £6.4 billion.** Non-EU Exports for October 2017 were £15.3 billion, an increase of £1.5 billion (11%) compared with September 2017, and an increase of £1.0 billion (7%) compared with a year ago. Non-EU Imports for October 2017 were £21.6 billion, a decrease of £2.3 billion (10%) compared with September 2017, but an increase of £2.4 billion (12%) compared with a year ago.<sup>(4)</sup>

## Consumer sentiment

- **The Consumer Prices Index, including owner occupiers' housing costs, (CPIH) 12-month inflation rate was 2.8% in November 2017, unchanged from October 2017.** Meanwhile, the Consumer Prices Index (CPI) 12-month rate accelerated to 3.1% in November 2017, up from 3.0% in October 2017. This marks the highest level since March 2012, and has **required the Governor of the Bank of England to write a letter to the Chancellor explaining why the central bank has missed its inflation target.**<sup>(5)</sup>
- **The volume of retail sales rose by 1.1% in November 2017 compared to October 2017 and 1.6% compared with November 2016.** Furthermore, the underlying pattern in the retail industry in November 2017, as suggested by the three-month on three-month measure remains one of growth, with the quantity bought increasing by 0.8%. However, **total average store prices increased by 3.1% in November 2017** when compared with the same period last year, with price increases across all store types.<sup>(6)</sup>

# Key sectors & business investment

## Business Investment

- According to the **Lloyds Bank Regional Purchasing Managers' Index (PMI)**, growth in business activity fell slightly the North West in November 2017, with the PMI dropping from 57.9 in October to 55.7 (above 50 = growth). However It has since risen in December to its highest level in over three years (58.5). This places the North West as the best performing region in the UK, marginally overtaking Wales (58.3).
- At the national level, all regions continue to see strong growth, with the combined Manufacturing and Services PMI Index for England rising to a 55.4 in December, down from 56.0 in October however up from a 54.6 in November. Business expansion and efforts to boost capacity have continued to result in higher employment levels across the private sector economy, with all regions except the South East seeing an increase in employment, where workforce numbers fell marginally for the first time in 16 months. December's data also indicated an increase in inflationary pressures, with the steepest rise in average prices charged for goods and services for more than nine years. This suggests that there are reasons to remain cautious going forward.<sup>(7)</sup>

## CIPS Manufacturing PMI to end December 2017



## Manufacturing

- **The IHS Markit/CIPS UK Manufacturing PMI® was 56.3 in December, down from November's 51-month high of 58.2.** The headline PMI for the sector has remained above the 50.0 no-change mark for 17 consecutive months. Although December saw rates of expansion in output, new orders and employment slowed from November's highs, whilst growth in all three remained solid and above long-run trend. Part of the increase in new business at UK manufacturers reflected a solid increase in new export sales.<sup>(9)</sup>

## CIPS Services PMI to end December 2017



## Services

- **The IHS Markit/CIPS UK Services PMI® was 54.2 in December, up from 53.8 in November.** New business volumes increased at a solid pace, but the latest upturn was the slowest recorded since August 2016. Reports from survey respondents suggested that subdued business investment and cost consciousness among clients were factors that had weighed on sales growth in December. Job creation was the lowest in nine months and input cost inflation hit a 3-month high amid a rise in fuel prices, utility bills, and salary payments.<sup>(10)</sup>

# Trade, regulation and access to funding

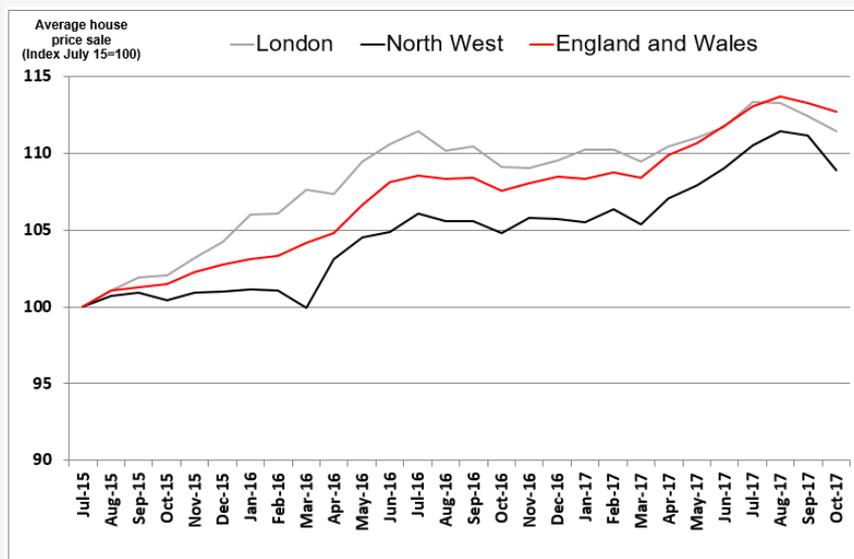
## Trade, rules and regulatory developments

- In a summit in Brussels on December 15, EU leaders endorsed the European Commission's recommendation that the British government had given enough guarantees on the three key divorce issues of the Brexit bill – the financial settlement, the rights of EU citizens and the Northern Irish border – to begin talks on its future relationship with the bloc.<sup>(11)</sup> As a result, the EU has published its guidelines for the next stage of negotiations:<sup>(12)</sup>
  - **Negotiations**, can only progress as long as all commitments undertaken during the first phase are respected in full and translated faithfully into legal terms as quickly as possible. The guidelines of 29 April 2017 continue to apply in their entirety. The European Council reconfirmed its desire to establish a close partnership between the Union and the UK, but emphasises that an agreement on a future relationship can only be finalised once the UK has become a third country.
  - **Transition**, the EU agrees to negotiate a transition period covering the whole of the EU acquis (EU law), while the UK, as a third country, will no longer participate in or nominate or elect members of the EU institutions, nor participate in the decision-making of the Union bodies, offices and agencies. Such transitional arrangements, which will be part of the Withdrawal Agreement, must be in the interest of the Union, clearly defined and precisely limited in time.
  - **Law and regulation**, changes to the acquis (EU law) adopted by EU institutions, bodies, offices and agencies will have to apply both in the UK and the EU. All existing Union regulatory, budgetary, supervisory, judiciary and enforcement instruments and structures will also apply, including the competence of the Court of Justice of the European Union.
  - **Trade policy**, as the UK will continue to participate in the Customs Union and the Single Market during the transition, it will have to continue to comply with EU trade policy, to apply EU customs tariff and collect EU customs duties, and to ensure all EU checks are being performed on the border vis-à-vis other third countries.
- The **Local Government Association** has highlighted concerns about how the government will replace the £8.4 billion local communities around the UK currently receive from the EU Structural Fund, but has welcomed the news that the rights of EU residents in the UK will be protected to avoid an immediate labour shortage and ensure business continuity.<sup>(13)</sup>
- **CITI REDI** has indicated that 2.5 million jobs (8.2% of UK employment) and 8.5% of GDP involves cross-border movement of goods or labour with the EU and is thus at risk due to Brexit. They highlight that service industries are more at risk than previously thought, including a wider variety of services than only the financial sector which have been the popular focus.<sup>(14)</sup>
- **IPPR** has proposed six broad principles for how the UK might reform immigration policy post-Brexit to address any possible negative impacts to the economy, and in particular to different regions of the UK. This includes abandoning crude migration rates as a target for government policy and distinguishing between migrant groups in targets, as well as ensuring migrant labour moves to regions where they are most needed.<sup>(15)</sup>
- The **FT** has modelled how international export markets will change up to 2050 and identified Malaysia, Bangladesh, Egypt and Pakistan as those that will grow most significantly as potential markets, although the EU, US, and China will remain the largest.<sup>(16)</sup>

# Property and investment, housing, and planning

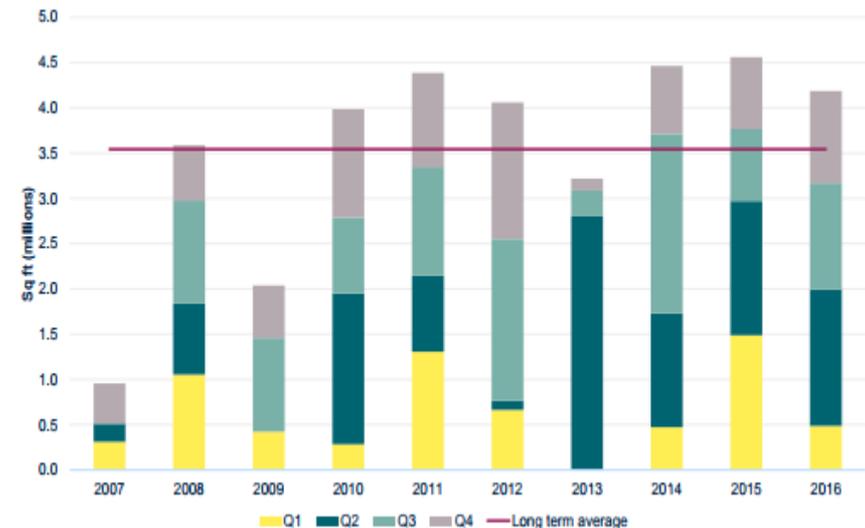
- **Housing data from the Land Registry continues to show that the vote to leave the EU has had little impact on house prices**, with average house prices in the North West rising by 3.8% on the level recorded in July 2016.
- **Commercial property:** This month's Monitor looks at demand in the big shed market in the North West. The latest Big Shed Report from **Savills** has described 2016 as being "a healthy year for the market", while noting that despite the North West having the highest amount of available space of all the regions in the UK, 75% of the units available are either of Grade B or C quality.

**Average House Prices Sales (Index July 2015=100)**



- **Housing Index** data from the Land Registry suggest the vote to leave the EU continues to have little impact on house prices, with moderate growth in average residential prices this period.
- **The latest house price data (October 2017) for the North West reveals an average price of £154,056**, a decrease of 2.0% from the previous month, and growth of 3.9% from October 2016.<sup>(17)</sup>

**Commercial Property: Big Sheds take-up**

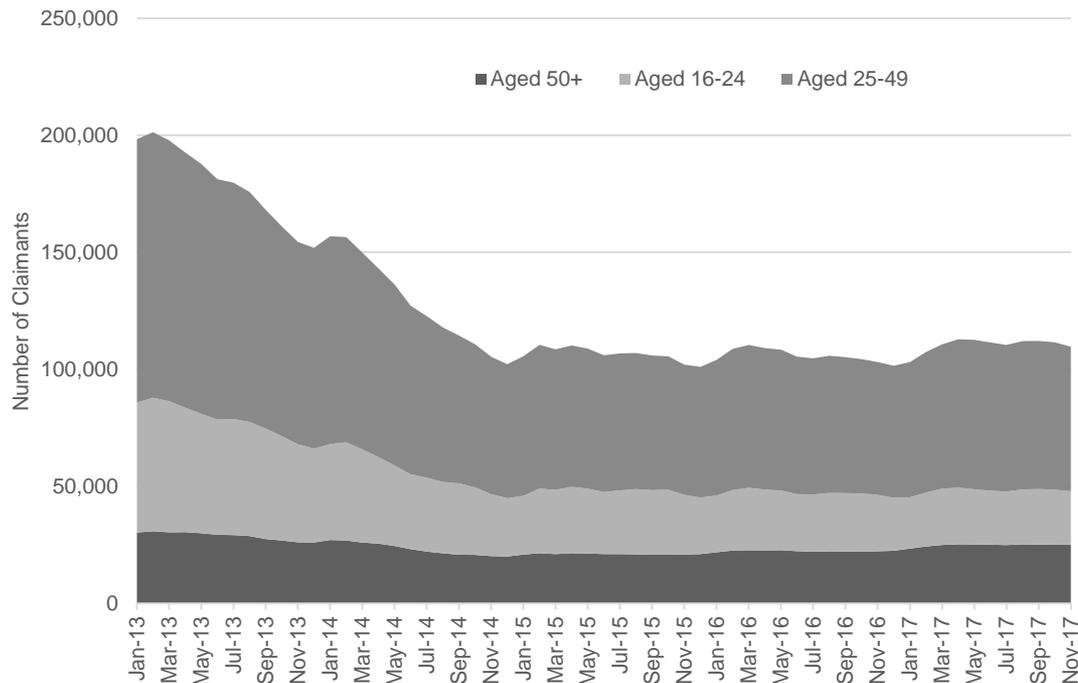


- Big Sheds take-up reached 4.2 million sq ft in 2016. Although this was 8% below 2015 take-up it was still 18% above the long-term average highlighting strong occupier demand.
- There were 22 deals recorded in 2016 which is the second highest amount since 2007 underlining the high liquidity evident in the market.
- Grade A space accounted for 72% of all space transacted in 2016.<sup>(18)</sup>

# Economic Inclusion

- **Unemployment:** Total claimant count unemployment in the North West declined by 1.7% in November 2017 (latest) compared to October 2017 to 109,670 a 9-month low. However this remains higher than one year previous (103,140 in November 2016), and 4.0% higher than June 2016.<sup>(19)</sup>
- December data revealed a sustained squeeze on UK household finances, driven by another sharp rise in living costs and corresponding decline in cash available to spend. **The seasonally adjusted Household Finance Index (HFI) – which tracks Britons' sense of financial wellbeing – registered 43.9 in December**, and while this is a slight improvement from November's 43.5, it remained below 50, signalling a deterioration. Moreover, December data revealed that inflation expectations were at their highest since February 2014.<sup>(20)</sup>

Claimant count (JSA and out-of-work UC) in GM by age group



Monthly Unemployment by age of resident

- As a proportion of working age residents, the **North West claimant rate for November 2017 (2.4%) remains above that the UK (1.9%)**.
- Within the region the claimant rate varies from 2.9% in Liverpool CR, 2.6% in Greater Manchester, 2.4% in Lancashire, 1.8% in Cumbria, 1.6% in Cheshire and Warrington.
- **In November 2017, the total claimant count for the 16 to 24 age group fell by 3.0% (710) from October 2017.** In the 25 to 49 age group it decreased by 1.9% (1,175), and for the 50+ age group it remained the same.
- **Since the referendum result in June 2016, the number of claimants aged 50+ has increased by 12.8% (2,860), and the number aged 25-49 has increased by 5.2% (3,040).**
- The number of claimants aged 16 to 24 however has decreased by 6.7% (1,640).



# Sources (2)

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<b>Investment, housing, property and planning</b>	<p>17. UK Land Registry (October 2017): House Price Index Database, accessed 02 January 2017 <a href="https://www.gov.uk/government/statistical-data-sets/price-paid-data-downloads">https://www.gov.uk/government/statistical-data-sets/price-paid-data-downloads</a></p> <p>18. Savills (31 January 2018): Big Shed Briefing, January 2017 <a href="http://www.savills.co.uk/research_articles/205506/213778-0">http://www.savills.co.uk/research_articles/205506/213778-0</a></p>
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