

North West Brexit Monitor

Key economic and policy developments

October 2016

Executive Summary

While national industry indicators continue to improve, **Lloyds Regional Purchasing Managers Index shows a slower rate of growth in NW business activity in September after two consecutive months of growth.** Significant depreciation of Sterling against both the Euro and the Dollar is now beginning to factor in to the real economy, with exporters receiving a boost to competitiveness while effective importers (including retailers, holiday-makers and overseas pensioners) see costs rise.

This briefing monitors the economy post the EU Referendum. The following section sets out the headline findings. More detail and all sources used are shown in the main section.

Macro economy:

- **Lloyds Bank's Regional PMI suggests increases in business activity slowed in the NW in September**, in contrast to more positive national PMIs, which indicate stronger growth in both manufacturing and services. Retail spending continued to grow in September, though increased input prices are driving upward inflationary pressures.
- **Inflation is expected to increase noticeably in the medium-term**, with the dispute between Tesco and Unilever shining a light on supply chain battles to factor in new costs. **Drivers are likely to see sharp increases in the price of petrol** as a rise in the global price of crude is compounded by Sterling's depreciation against the Dollar.
- **HM Treasury remains silent ahead of the Autumn Statement**, though Phillip Hammond has announced £220m of funding for tech innovation and £5bn of support to housing developers.

Sectors & business investment:

- Members of the Regional Manufacturing Forum (RMF) reported that to date there has been **limited impact on the sector and particularly for SME's**. Many have been benefiting from strong order books and growing export potential, but there is **concern that the rising cost of imports over the longer term may affect their activities**. Likewise that there could be **further skilled labour shortages if access to skilled labour is effected by the outcome of the Brexit negotiations and impacts to activities funded through European programmes** e.g. ESIF. Multinationals and PRIMES within the sector could be at higher risk of relocation over the longer term.

Executive summary

Terms of trade, regulation & access to European funding:

- To date there have been no decisions related to terms of trade and rules and regulations, though **talk of a 'hard Brexit' preoccupied much of the Conservative Party Conference and subsequent national debate.**
- Government has stated that all ESIF (ERDF & ESF) projects securing funding before the point at which the UK leaves the EU will have their funding guaranteed. The statement means that **any project which is contracted before leaving the EU will be funded either from EU resources or from domestic resources if the project continues beyond the point of the UK's departure from the EU.**

Property investment, housing and planning:

- To date, **there have been no announced changes to local or national planning policy**, though Phillip Hammond announced £5bn to support new housebuilding at the Conservative Party Conference.
- Official Housing Index **data from the Land Registry suggests Brexit has had little impact on house prices**, with continued moderate growth in average sales this period.
- **There is evidence of significant property deals still being made in GM**, with Deka Immobilien acquiring One St Peter's Square in Manchester for £164m.

Economic inclusion:

- Government has announced a new Inclusive Economy Unit, which will 'focus on **expanding opportunities for those who are struggling** to cope; **harnessing the power of private investment and business for the advantage of everyone** as well as **improving delivery of public services**'. The unit will utilise existing resource in DCMS.
- There has been a marginal increase in unemployment in GM since the referendum but **it is too early to assess the longer-term impact of Brexit. Inflation remained at 0.6% in August**, against BoE predictions for the rate to rise to 0.8% in 2016. However, input price rises across import-price sensitive components of the CPI, and recent disputes between producers such as Tesco's and Unilever, point to **increasing inflationary pressures in the medium-term.**

Macro-economic trends and developments

Macro-economy

- **GDP growth for Q2 2016 was revised up by 0.1pp to 0.7%.¹** Growth in manufacturing output, however, was revised down to 1.6% from 1.8%; it still stands at a six-year high. Gross fixed capital formation showed stronger growth than estimated, up by 0.2pp to 1.6%, reflecting upward revisions to business investment. In particular, investment by the manufacturing sector increased by 0.8% in Q2 2016. Employment in the manufacturing sector posted positive growth for the third quarter in a row, increasing by 0.5% on the previous quarter.²
- The **MPC announces their next interest rate decision on 3rd November**, though the broad consensus is that, at 0.25% rates, orthodox monetary policy is nearing the limits of effectiveness. Speaking in Manchester, MPC member Michael Saunders suggested that, while the bank wasn't too concerned about volatility in Sterling which has led significant depreciation against the Dollar and Euro, this **could lead to import price increases of 12%-13%, leading to consumer inflation of around 3%-4% over the next three or four years³**.
- Sterling depreciation has been of short-term benefit to the FTSE100, which has approached near record highs in recent days – in large part due to the significant proportion of total revenue generated in Dollars⁴. The FTSE 250, meanwhile, has been supported by M&A activity and the underlying economic resilience of the UK, though remains vulnerable to domestic economic developments as a result.
- Treasury remains largely silent ahead of the Autumn Statement. However, speaking at the Conservative Party Conference, Phillip Hammond announced **£220m to support tech innovation** and highlighted **£5bn funding to the housing sector** announced earlier by DCLG minister Sajid Javid⁵.

British Chamber - Quarterly Economic Survey, Q3 2016 (1)

Business and consumer sentiment



Following two consecutive months of growth, Lloyds Bank's Regional PMI suggests **business activity in the NW grew at a slower rate in September**, falling from 55.7 to 53.8, below a England average of 54.0, which was up from 53.7 in August⁶.

The NW results move against Markit's national PMIs, which records that **firms are bouncing back from the immediate shock of the referendum vote**, with new business and activity in Services and output, new orders and employment in Manufacturing all growing⁷.

British Retail Consortium/KPMG research shows **growth in retail spending, focusing on food, big-ticket items and back-to-school purchases**, resulting in September sales up 1.3% on the previous year⁸.

However, BRS and IHS Global Insight economists highlight medium-term risks to consumers of input prices putting pressure on inflation and a weakening of economic fundamentals⁹.

Key sectors & business investment

Key development in Manufacturing – Government provides assurances to Nissan

Following meetings between Theresa May and Nissan CEO Carlos Ghosn, the Japanese company has confirmed that it will proceed with a significant investment in Sunderland to manufacture its Qashqai and X-Trail models post Brexit¹⁰. Though Government has denied offering the firm a 'sweetheart deal' to encourage investment in the plant, this suggests that **Government could pick favoured sectors to shield from the impact of Brexit**. Nissan had previously said it will not invest any further unless the government offered assurances that it would not face greater tariffs, or that it be compensated. **The carmaker's decision on whether to build its new Qashqai SUV in Sunderland is reported to be within the next 2-3 months¹¹**. The UK automotive sector has been one of the UK's manufacturing success stories in recent years, and its **supply chains extend to several sectors, including firms located in GM**.

ONS - UK Seasonally adjusted production & manufacturing



Manufacturing - enjoys its strongest quarter this year (6)

- This monitor includes the second release of Index of Production (IoP) covering data post EU referendum, released 7 October.¹²
- Since early 2014, manufacturing – the largest component of production – has experienced alternating periods of expansion and contraction, remaining broadly flat over this period.
- In August 2016, manufacturing grew by 0.2% compared with July 2016, with output at roughly the same level as the average in 2015.
- The manufacturing of transport equipment provided the largest contribution to growth, increasing by 2.5%.

Markit/CIPS - Survey of manufacturing purchasing managers



Growing domestic orders and increasing demand from overseas

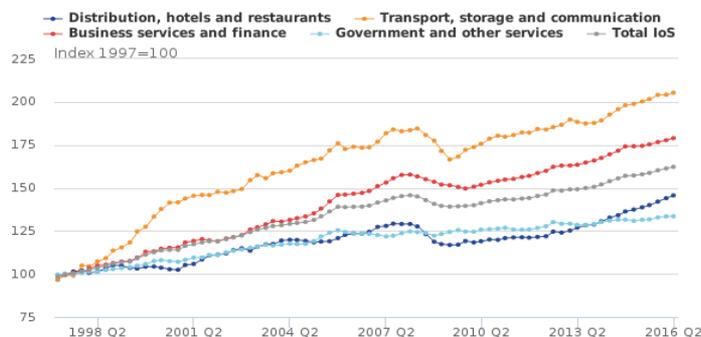
- UK manufacturing activity expanded again in September as new domestic orders and increasing demand from overseas helped the sector achieve its strongest quarter of growth this year.
- The Markit/CIPS survey of manufacturing purchasing managers rose to a 27-month high of 55.4 in September, up from 53.4 in August and following a sharp fall to 48.3 in July. This is the highest level the index has reached since June 2014. Any result above 50 signals an expansion in activity.¹³

Key sectors & business investment

Quarterly Economic Survey

- The latest data from the QES shows continued but weaker growth in the third quarter of 2016. Manufacturers reported a contraction in output for the first time since Q1 2013, after sustained growth. The service sector reported a slow-down in growth, but continued expansion; and construction remaining confident in local development growth. Employment levels continue to remain positive across all sectors of the economy, though manufacturing's rate of job growth has been slowing in the latter part of this year. For both service sector and construction, job growth remains strong. More positively, manufacturers have seen strong growth in international sales this quarter.

ONS - Index of services and sub-components



Services – No post-referendum impact evident

- The first release of Index of Services (IoS) covering a full month of data following the EU referendum shows no evidence of any significant impact from the outcome.¹⁴
- Services output increased by 0.4% between June 2016 and July 2016, and have increased by 2.9% in July 2016 compared with July 2015. In order of their contribution to growth:
 - business services and finance increased by 2.6%
 - distribution, hotels and restaurants increased by 4.5%
 - transport, storage and communication increased by 4.1%
 - government and other services increased by 1.9%.

Markit/CIPS - Survey of services purchasing managers



Service sector business activity and employment continues to rise

- The Markit/CIPS UK Services PMI decreased slightly to 52.6 in September of 2016 from 52.9 in August, but beating market expectations of 52. Business activity rose for the second month, new business increased the most since February, job creation picked up while input prices rose the most since February of 2013.¹⁵
- Services PMI in the United Kingdom averaged 53.94 Index Points from 2007 until 2016, reaching an all time high of 62.50 Index Points in October of 2013 and record low of 40.10 Index Points - November 2008.

Key sectors & business investment

Update from the Regional Manufacturing Forum

- Members of the Regional Manufacturing Forum (RMF) reported that to date there has been limited impact on the sector and particularly for SME's. Many have been benefiting from strong order books and growing export potential, but there is concern that the rising cost of imports over the longer term may affect their activities. Likewise that there could be further skilled labour shortages if access to skilled labour is effected by the outcome of the Brexit negotiations and impacts to activities funded through European programmes e.g. ESIF. Multinationals and PRIMES within the sector could be at higher risk of relocation over the longer term.

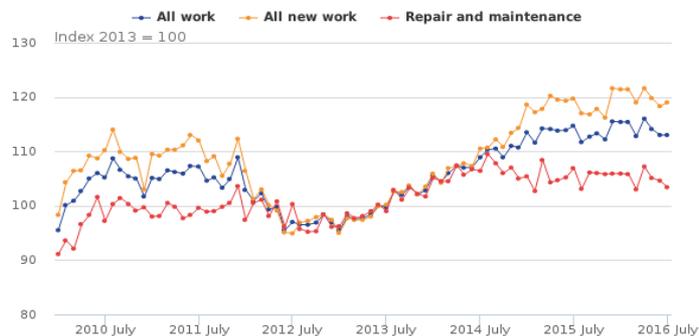
UK Retail quantity, spending and average store prices



Retail growth year on year, but spending mix changes...

- In August 2016 the quantity bought (volume) of retail sales is estimated to have increased by 6.2% compared to August 2015; all store types except clothing and footwear, and household goods showed growth with the main contribution coming from food stores.
- The amount spent in the retail industry increased by 4.1% compared with August 2015 and decreased by 0.5% compared with July 2016.
- The amount spent online increased by 18.5% compared with August 2015 and increased by 0.4% compared with July 2016. Non-seasonally adjusted average store prices (including petrol stations) fell by 1.9% in August 2016 compared with August 2015.¹⁷

UK Construction: All work, July 2016



Construction output shows little month on month, year on year growth

- In July 2016, construction output was estimated to have shown no growth compared with June 2016. All new work increased by 0.5% while all repair and maintenance decreased by 1.1%.
- Compared with July 2015, construction output decreased by 1.5%. All new work, and repair and maintenance fell by 0.6% and 3.2%.
- New orders for the construction industry in Q2 (Apr to June) 2016 were estimated to have increased by 8.6% compared with Q1 (Jan to Mar) 2016 and increased by 7.5% compared with Q2 2015. New housing increased by 25.0%, but there was a fall of 17.4% in infrastructure.¹⁸

Trade, regulation and access to funding

Terms of trade, rules and regulatory developments

- Recent speeches by Liam Fox hint at a 'hard Brexit' stance, with the suggestion that this was a **'golden chance' for trade with other markets**. Speaking in Manchester, Fox said the UK had played a large role in ensuring the single market remained open to trade and would continue to encourage this liberalisation. But, he added: "through the WTO the UK has helped pushed through the trade facilitation agreement which, once implemented, could add over £70bn to the global economy annually, of which £1bn will come to the UK."¹⁹
- Having previously indicated that Government would seek to deliver on the result of the referendum without extensive parliamentary debate, **Theresa May and other senior cabinet members have endorsed a concession requiring "full and transparent" parliamentary scrutiny before triggering Brexit.**²⁰
- The Bank of England confirmed that **on Tuesday 11 October that Sterling fell to its lowest level against the currencies of the UK's main trading partners since the BoE started measuring in 1990**. It was 31 per cent lower than at its peak in January 2007. Sterling's fall, could increase demand for British exports and lead to some shift of consumption towards domestic production, but as it increases inflation through higher import prices, it could also reduce consumer spending.²¹
- Delivering her keynote speech to the Conservative Party Conference, **Theresa May announced a 'Great Repeal Bill' which will be included in the next Queen's Speech**, expected next April, with the bill designed to repeal the European Communities Act 1972 as and when the UK leaves the European Union. **The Prime Minister also set the deadline for invoking Article 50 by the end of March 2017.**²²

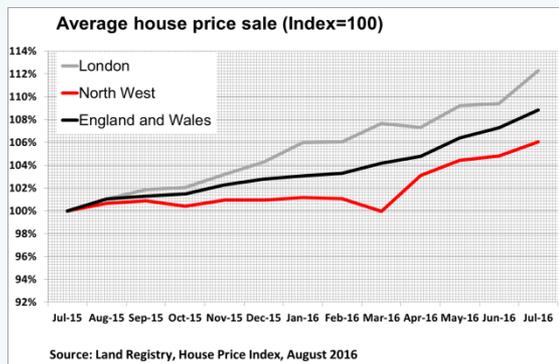
Access to European funding

- On 13th August, the Chancellor of the Exchequer released a statement setting out Government's intention that in the short term all ESIF projects that are contracted by the 2016 Autumn Statement (23rd November 2016) will be funded. This has since been updated in an announcement on the 3rd October that all projects securing funding before the point at which the UK leaves the EU will have their funding guaranteed.²³
- These announcements apply, not only to ESIF projects, but to all EU funded activity and so also encompasses EAFRD (rural), Erasmus+, Horizon 2020, Interreg, URBACT and so on. The statement means that **any project which is contracted before leaving the EU will be funded either from EU resources or from domestic resources if the project continues beyond the point of the UK's departure from the EU.**
- Should this guarantee be as comprehensive as it appears, it potentially amounts to a major protection against the chief danger for partners in getting involved in trans-national projects: namely, that the UK might exit the EU part way through the project and funding for involvement in the project would cease.

Property investment, housing and planning

The Prime Minister has already stated that infrastructure, energy and housing policy will play a major part in her economic strategy to tackle Britain's low productivity. Housing remains high on the political agenda; and support for construction of infrastructure and housing will have the potential to provide employment to mitigate any risks that could emerge, if the UK sees slower economic growth. New homes sales across the UK are slower, but so far there has been no real impact on pricing outside London. However, it is too early to draw any conclusions as to the impact of 'Brexit' but activity across the UK over the last few weeks is encouraging.

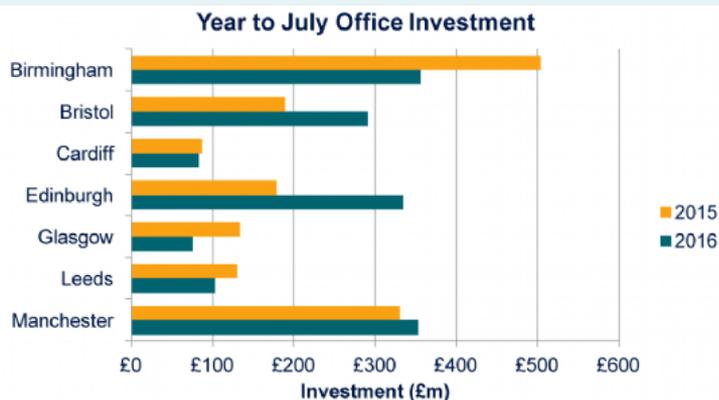
Average House Prices Sales



UK Housing Markets

- Official Housing Index data from the Land Registry suggests Brexit has had little impact on house prices, with continued moderate growth in average sales this period.²⁴
- The Nationwide Housing Price Index shows that house prices increased by 0.3% in September, however year-on-year house price growth slowed to 5.3% from 5.6% in August.²⁵
- There were tentative signs of a convergence in house price growth amongst the English regions (year to date). Most southern regions saw a slowing in price growth, whilst the North West saw a pick-up in growth.

Nationwide – Seasonally adjusted house prices



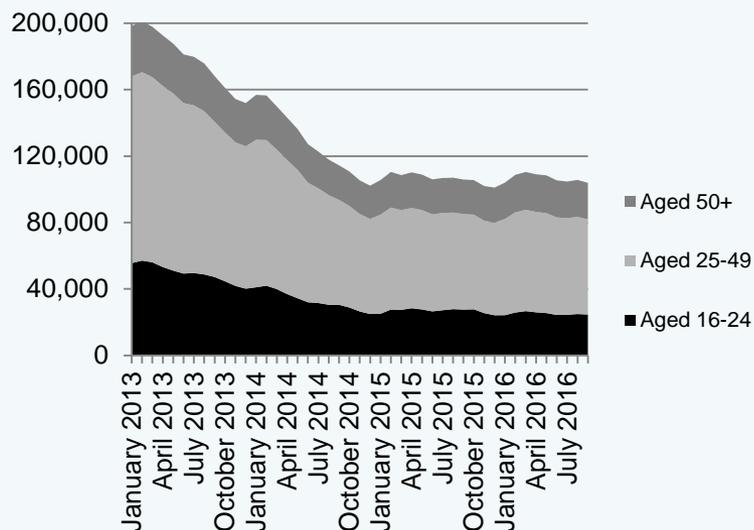
GM Property Investments

- According to Savills - despite pre-referendum concerns, the M25 and regional office investment volumes remained strong as at the end of July 2016 (£3.7bn) 37% above the long term average for this period.²⁶
- Bristol, Edinburgh and Manchester have all seen higher investment levels in 2016 than the same period in 2015.
- Post-Brexit, encouragingly, there is evidence of significant deals still being done. For example, Deka Immobilien has acquired One St Peter's Square in Manchester for £164m via the owning joint venture vehicle from Argent and the Greater Manchester Property Venture Fund.²⁷

Economic Inclusion

- **Achieving higher levels of economic inclusion is an aspiration for councils across the North West.** The RSA's Inclusive Growth Commission released its interim report in September with a final report due in Spring 2017. Interim recommendations stress the importance of recognising the value and differences between places, be they city regions or non metropolitan areas, and in understanding the role that they can play in driving economic growth.
- Delivering her keynote address to the Conservative Party Conference, **Theresa May reiterated her commitment to worker representation on company boards and prioritised the protection and enhancement of employee rights in the UK outside of the EU.** Noting the 'quiet revolution' of the referendum result, the Prime Minister emphasised the need for society, the economy and democracy that "truly works for everyone, not just a privileged few".²⁸
- Separately, government has announced a new Inclusive Economy Unit to be based in DCMS. Building on the work of the work of the Social Investment and Finance Team, **the unit aims to encourage better use of private investment to deliver social impact, improve delivery of public services and encourage responsible business.**²⁹
- **REC research continues to position the North above the UK average in terms of placements, with increased client confidence reported.** However, a drop in permanent candidates and a narrowing of pay growth may threaten sustainable economic growth.³⁰

Claimant count (JSA and UC) unemployed by age group



Monthly Claimant Count Unemployment by age of resident

- Following a small increase in unemployment in the NW in August, **September data from ONS shows an above average decline of 1.65% from 105,700 to 103,900.** The compares favourably with other regions, with the South East seeing an increase of 0.31%, and outperforms the UK average of a 1.35% fall.³¹
- NW unemployment fell across all age groups in September 2016, falling most sharply for those aged 25-49 (-2%). With an average fall of 1.4% across all age groups, NW claimant count fell by 1,750.
- Inflation remained at 0.6% in the year to August – well below the BoE 2% target. However, **underlying components of the CPI are starting to see upward pressure as input prices rise,** with Tesco's recent dispute with Unilever over supplier prices highlighting the battle over who should carry the cost of price increases.³²

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