North West Brexit Monitor

Key economic and policy developments

November 2016

Executive Summary

Building on momentum highlighted in previous Monitors, **latest data appears to suggest the economy is continuing to grow, with exports benefitting from the devaluation of the pound**. However, a recent High Court judgement concerning the implementation of Article 50, and the election of Donald Trump in the USA, have added further uncertainty to local and global markets, all while input costs and forecast inflation rise sharply.

The following section sets out the headline findings. More detail and all sources used are shown in the main section.

Macro economy:

- **Phillip Hammond will deliver his first Autumn Statement on 23 November,** which is expected to include the first indications of the Government's economic and fiscal response to the Brexit vote. New Economy will release a briefing shortly after the announcement for the North West.
- **Lagging supply-side analysis suggests that GDP growth has been driven by a strong increase in output by the Services sector (+0.8%)**, with ONS data suggesting that output in all other sectors decreased in Q3 compared with Q2. In contrast with leading indicators provided by private-sector sources elsewhere in this report and in previous Monitors, ONS data shows **Manufacturing contributed most to the decrease in the index for production, having fallen by 0.9% in Q3**[2], highlighting the importance of considering a range of evidence in current market conditions.
- **Lloyds Bank's Regional PMI suggests business activity in the NW continued to grow in September, albeit at a slower rate than the UK average and previous months**. Retail spending also continued to grow in September, though increased input prices are driving upward inflationary pressures.

Key sectors and business investment:

- Markit PMI data continues to report **growth in business activity and output in both Manufacturing and Services sectors**. Though in contrast with later released index of production data, above, this momentum is reflected in ONS Index of Services data, which grew by 3.2% in August 2016.

Executive summary

Terms of trade, regulation & access to European funding:

- The High Court has ruled in favour of a challenge against the Government's plan to trigger Article 50 by royal prerogative, which, pending appeal, will mean **Parliament must now vote on the terms of the UK's approach to exiting the EU**.
- 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:

- The Prime Minister has stated that **infrastructure, energy and housing policy will play a major part in her economic strategy to tackle Britain's low productivity**.
- According to Savills - despite pre-referendum concerns, **office investment volumes remains strong in the M25 and NW at the end of July 2016** (£3.7bn), 37% above the long term average for this period.
- The Wall Street Journal reported in October that **investors are looking to cities like Birmingham and Manchester for property investment as an alternative to London**.

Economic inclusion:

- Markit's Household Finance Index (HFI) suggests that **UK households have seen a noticeable downturn in current finances during October**, due to increased inflation and income from employment nearly stagnant.
- Commenting on the Government's freeze of working-age benefit payments until 2019, former DWP secretary Iain Duncan Smith has suggested Phillip Hammond should review the policy in light of revised inflation estimates, which would result in a real terms cut in income for claimants.

Macro-economic trends and developments

Macro-economy

- **UK GDP grew by 0.5% in Q3 2016 according to the ONS.** Whilst slower than the 0.7% rate in Q2, this rate of growth exceeds estimates for the July – September period, which had been set at 0.3%. Year-to-year growth was also higher than expected, with UK GDP having increased by 2.3% over the course of the last 12 months, compared to a forecast of 2.1%.[1]
- **Supply-side analysis suggests that GDP growth has been driven by a strong increase in output by the Services sector (+0.8%).** However, all other sectors decreased output in the Q3 (Production by -0.4%; Agriculture by -0.7%; and Construction by -1.4%). **Manufacturing contributed to most to the decrease in the index for production, having fallen by 1% in Q3.**[2]
- **Recent evidence suggests a clear correlation between Brexit and the value and stability of Sterling**. Following an announcement in October by Theresa May on the timetable for negotiations to leave the EU under Article 50, the pound fell sharply against the dollar, decreasing in value by 1.2% and hitting a 31 year low of $1.28. Against the euro it fell by 0.9% to €1.12 - its lowest level since 2013.[3] Interestingly, the recent High Court ruling on Article 50 saw a sharp increase of 1.1% in value of the pound against the dollar and euro.[4]
- **As expected the Bank of England announced in early November that interest rates will remain at 0.25%**, however the longer term outlook for the UK economy appears to be turbulent, with the Bank's Monetary Policy Committee predicting rises in petrol prices and imported goods, the and also forecasts a rise in inflation from 1.3% this year to 2.7% in 2017 and 2018.[5]

Consumer sentiment

- **According to the latest CPI data (released in November 2016), inflation stood at 1% in September** – a significant increase from 0.6% in August, and its highest since November 2014. The main upward contributors to change in the rate were rising prices for clothing, overnight hotel stays and motor fuels, and prices for gas, which were unchanged, having fallen a year ago.[6] Higher inflation and currency fluctuations have led to predictions that consumer spending will weaken and wage growth will be overtaken by inflation.[7]

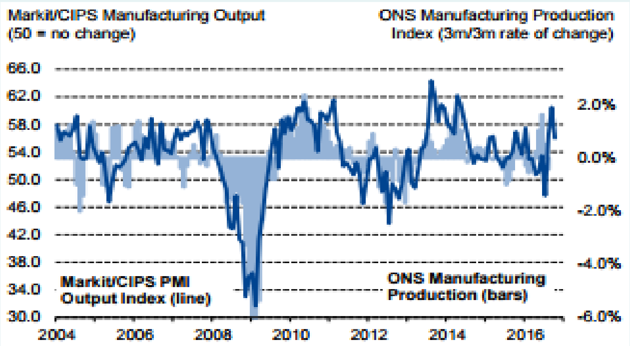
Public Service Spending

- Research by the Institute for Fiscal Studies suggests that **weak growth will drive down tax receipts in the UK, and forecast a £10.4 billion budget surplus in 2019-2020 being wiped out, forcing the government to borrow an extra £14.9 billion**. This analysis suggests that any savings from leaving the European Union's single market will be outweighed by lower growth and consequent budgetary shortfall.[8]

Key sectors & business investment

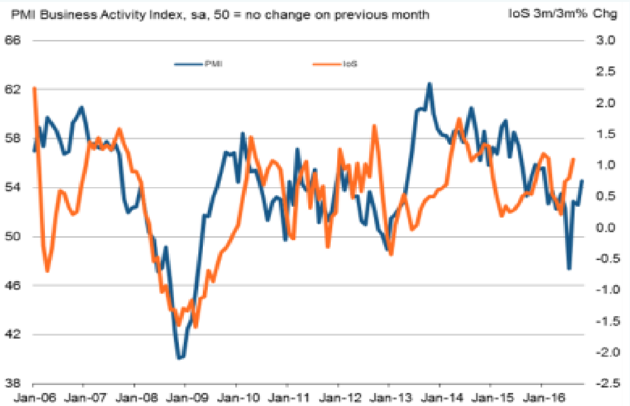
Business Investment

- Speaking at the CBI's annual conference, **Theresa May announced an extra £2bn a year by 2020 to fund R&D** – focussing on areas where the UK has traditionally been weak, such as commercialisation of academic research and patents. Commenting on the announcement, Juergen Maier, chief executive of Siemens UK and chairman of the NW Business Leadership Team, said "Brexit is without doubt creating uncertainty and that is not good for business. We see this as a bit of an antidote". May **highlighted the creation of an Industrial Strategy Challenge**, which could direct funding to emergent and breakthrough technologies in advanced manufacturing, digitisation, robotics and biotechnology.



Manufacturing

- Though down slightly on last month's data, **Markit/CIPS Manufacturing Index (54.3) remains well above long-run trends (51.5), with upturns in output, new orders and employment.**[10]
- While the weaker pound has benefitted exporters, there has been a sharp rise in input costs across consumer, intermediate and investment good sectors and for firms of all sizes. Construction output also increased – driven by residential work, but saw input prices continue to rise sharply also, at the second fastest rate since January 2011.[11]



Sources: IHS Markit, ONS

Services

- Markit/CIPS Services PMI data for November provides encouraging signs of growth in the UK's dominant sector, as **total business activity and new business expansion accelerated at the fastest pace since January**, with the Index rising to 54.5.[12]
- This momentum is reflected in ONS Index of Services data, which grew by 3.2% in August 2016 compared with August 2015 and by 0.2% on July 2016, with the ONS finding **"no evidence of a significant impact of the outcome of the EU referendum on August's services output figure."**[13]

Trade, regulation and access to funding

Terms of trade, rules and regulatory developments

- The High Court has ruled in favour of a challenge against the Government's plan to trigger Article 50 by royal prerogative, which, pending appeal, will mean **Parliament must now vote on the terms of the UK's approach to exiting the EU**.[14]
- The government has lodged an appeal against the judgement at the Supreme Court, which will hear the case in early December and could deliver a verdict in early January. Nevertheless, **Government has said it will deliver a full exit from the European Union, its Brexit timetable would not be affected and it is still intends to begin the process before the end of March**.[15]
- However, **Trade Secretary Liam Fox said the Government would have to wait for an appeal before it rolls out new plans for the Article 50 legal process.** In the mean time, Colombia president Juan Manuel Santos suggests that trade between his country and the UK has the potential to grow after the Brexit.[16]
- **The pound appreciated against all its major peers after the ruling**. However, investors believe turbulent market conditions – which have been exacerbated by the election of Donald Trump as President elect of the US – will persist, as world markets react to a possible reorientation of the US economy toward more protectionist policies.[17]

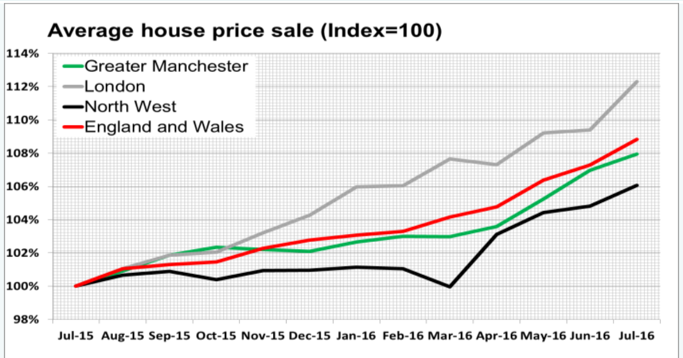
Access to European funding

- 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.
- 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



Source: Land Registry, House Price Index, August 2016

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.[18]
- Savills have produced a forecast of the housing market to 2021 and predict a 12% increase in house prices in the North West by 2021.[19]
- 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.

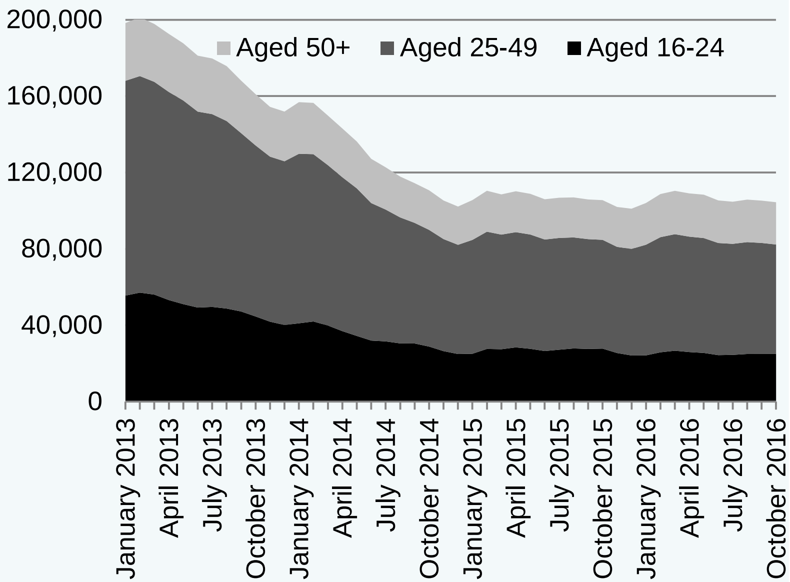
NW Office and Property Investments

- 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.20
- However, research by CBRE provides a more nuanced picture, with Liverpool city region seeing improved levels of office-space take-up in H1 2016 compared with 2015, while office take up in Manchester was lower than 2015 levels. They also note "There has been marginal growth in demand for companies looking to northshore from London, for example Freshfields, while inward investment remains strong with Lonza and Escada both opening new city centre operations."21
- The Wall Street Journal reported in October that investors are looking to cities like Birmingham and Manchester for property investment as an alternative to London.

Economic Inclusion

- The monetary policy committee has predicted inflation will rise from 1.3% this year to 2.7% in 2018, and has dropped plans for a further interest rate cut, maintaining the current rate at 0.25%.[22] Furthermore, Markit's Household Finance Index (HFI) suggests that UK households have seen a noticeable downturn in current finances during October, due to increased inflation and income from employment nearly stagnant.[23]
- Commenting on the Government's freeze on working-age benefits until 2019, former DWP secretary Iain Duncan Smith has suggested Phillip Hammond should review the policy in light of revised inflation estimates, which would result in a real terms cut in income for claimants.[24]
- A white paper on prison safety and reform, released by the justice secretary Elizabeth Truss, outlines plans to invest £104m to fund an extra 2,500 prison officers and build 10,000 modern prison places, including five small women's "community prisons". The reform emphasises the importance of safety and rehabilitation of offenders, with a view to reducing high levels of re-offending rates.[25]

Claimant count (JSA and UC) unemployed by age group[27]



Monthly Unemployment by age of resident

- **While the unemployment rate in the NW (2.3% of resident working-age population) is higher than the UK average (1.9%), there has been little change in rates and volumes since the EU referendum vote**, with a 0.8% decrease in October on the previous month. ILO unemployment in the NW remained at 5.1% - above the national level, which remained at 4.9%.[26]
- **GM 16-24 unemployment in October is down** 10% on October2015, though **this is partially offset by an increase in unemployment amongst 50+ year olds (6.5% increase, or 1,345 claimants).**
  - 16 to 24: There were 24,995 young people claiming JSA/UC in October 2016. This figure is down 2,780 on October 2015.
  - 25 to 49: There were 57,300 residents claiming JSA/UC in October 2016, up slightly on October 2016.
  - 50+: There were 22,135 residents aged 50+ claiming JSA/UC in October 2016.

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