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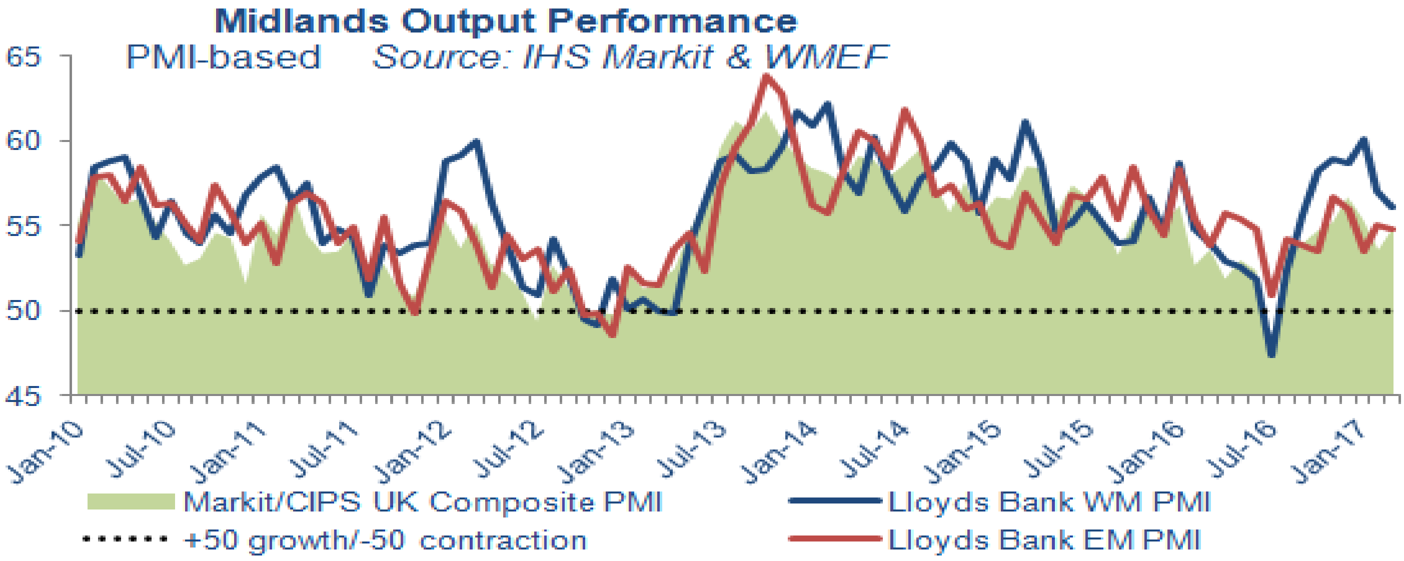
The Region's Robust Performance Continues in March

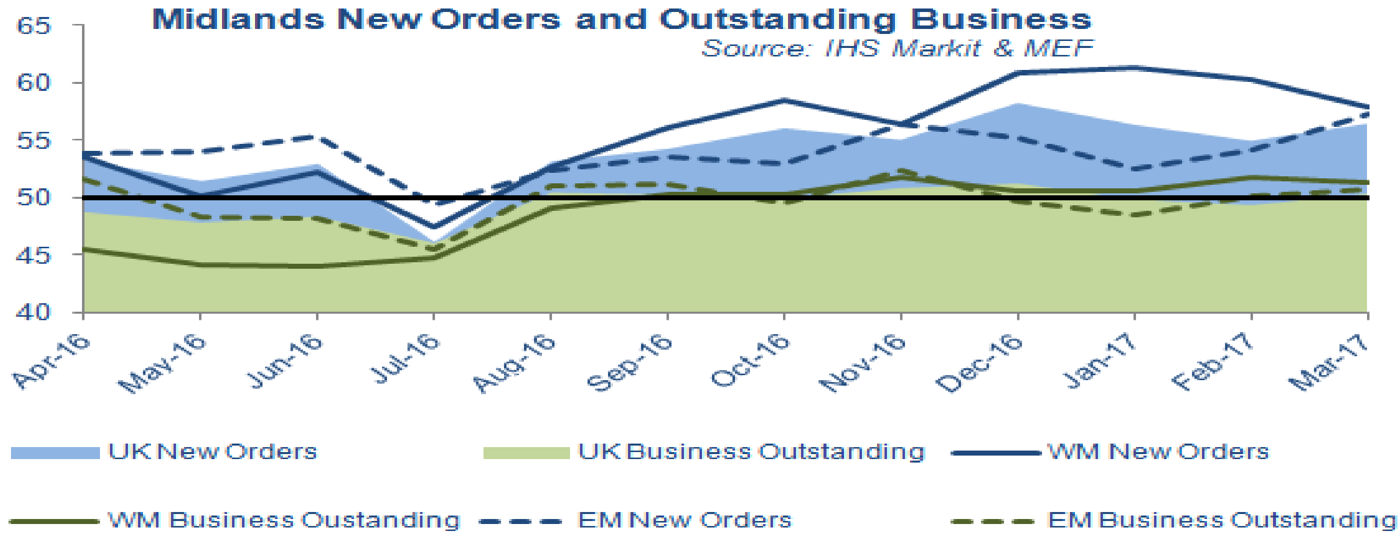
According to the latest Lloyds Bank regional PMI for March released today:

- Market sentiment likely to be drive by political, if not military factors over the next few weeks.
- China offers key trading concessions to US, notably on finance and agriculture
- Midlands PMIs softened in March, in the WM easing to 56.1 in March from 57 previously, and in the EM weakened more marginally to 54.8 from 55 in March compared to the UK overall figure of 54.9.
- Price pressures continue to accelerate, largely a result of the depreciation of Sterling and firming global commodity prices, most notably crude oil.
- Increased new business has led to an increase in business outstanding as order books have extended for firms, possibly leading to a rise in employment.
- Trade performance of the region softened slightly in 2016, mostly as a result of weaker performance in the EM.
- OECD Comparative Composite Leading Indicators suggest a potential slowing of British growth.

Market sentiment is likely to be driven by political, if not military concerns over the next few weeks. Further US intervention in Syria could seriously destabilise Washington's relations with Russia and push any rapprochement with Iran even further back. Whilst deployment of a US carrier strike group in Korean waters raises increasing concern of further unilateral action by the Trump administration in this instance against the North. This has tended to overshadow key trade concessions offered by PRC President Xi, notably on finance and agriculture, during talks at the Southern White House. Although these will serve to deflect attention from the Brexit process, the first 10 days since Article 50 was activated have already served to emphasise how difficult the talks may prove, with Britain potentially loosing diplomatic ground on Gibraltar, Ireland, and Scotland, even before the negotiating agenda is agreed.

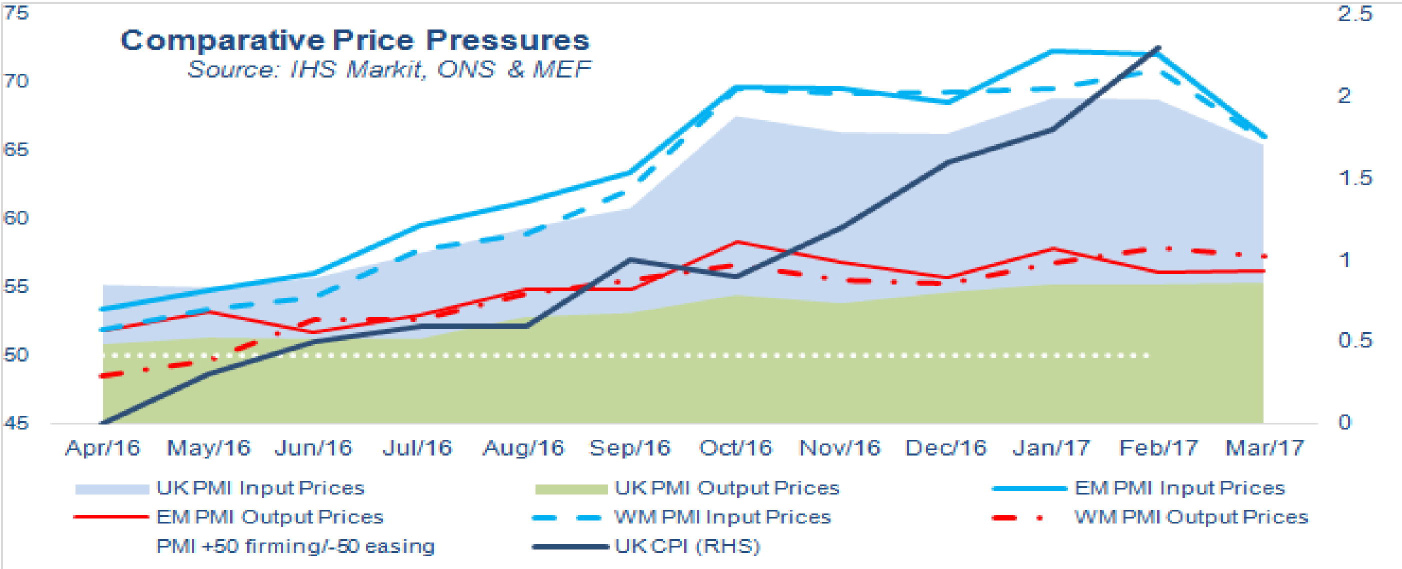


Moreover, recent economic data has indicated some easing of performance in Britain, coupled with an acceleration of price pressures, and this has borne out by today's regional PMI release. The latest regional PMI data shows a softening but still robust performance in the Midlands PMIs, down from 57.0 in February to 56.1 in March in the WM, and down from 55.0 to 54.8 in the EM, compared to the UK overall of 54.9 in March. This reflects the softening seen in the UK manufacturing and construction PMIs in March, and in official data with short-term indicators showing slowing but still positive output performance.



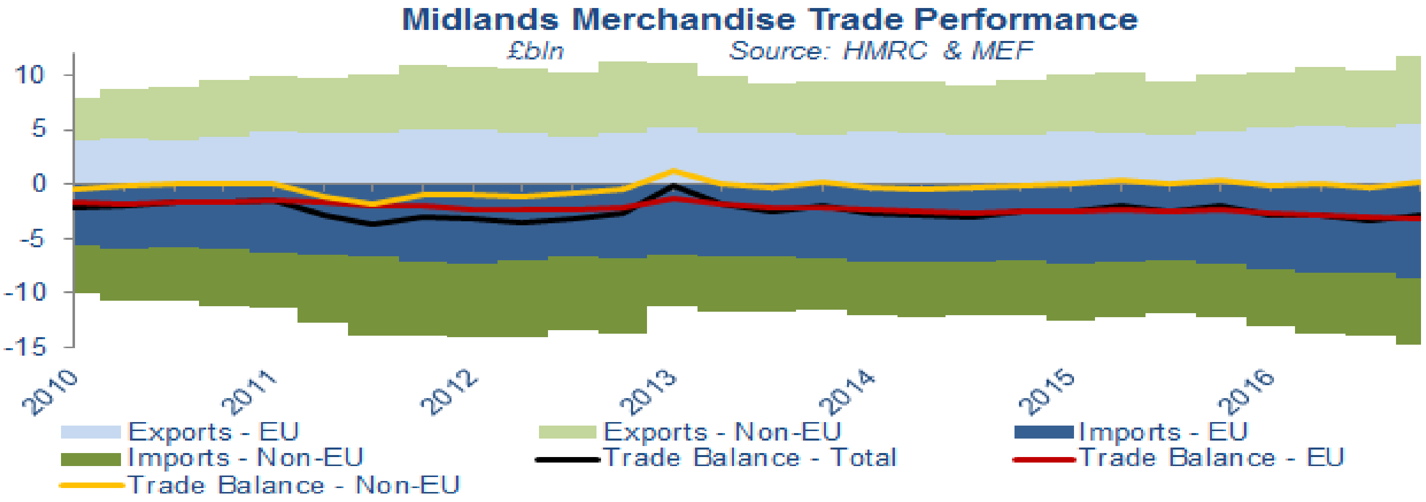
Nevertheless, UK manufacturing, construction, and services PMIs all reported an increase in confidence for the next twelve months, with confidence in the manufacturing sector reaching a ten-month high. A lowering of Brexit uncertainty among clients was reported, providing a boost to output demand. There was also increased demand and interest from foreign markets, most probably due to the lower value of Sterling making UK businesses more internationally price competitive.

The UK PMIs saw increases in new orders in March, with further demand from foreign markets for manufacturers and services providers and lower anxiety surrounding Brexit was a contributing factor for construction. The Midlands appears to be outperforming the UK in terms of new orders, in particular the WM, although the EM saw the fastest rise in new orders for over a year in March. This has led to business outstanding in the Midlands to grow so that it is now on a par with that in the UK. As business outstanding increases, there could be an increase in employment as companies increase their capacity to deal with new business. This was reflected in March's PMIs, with both EM and WM showing employment growth above the UK overall.

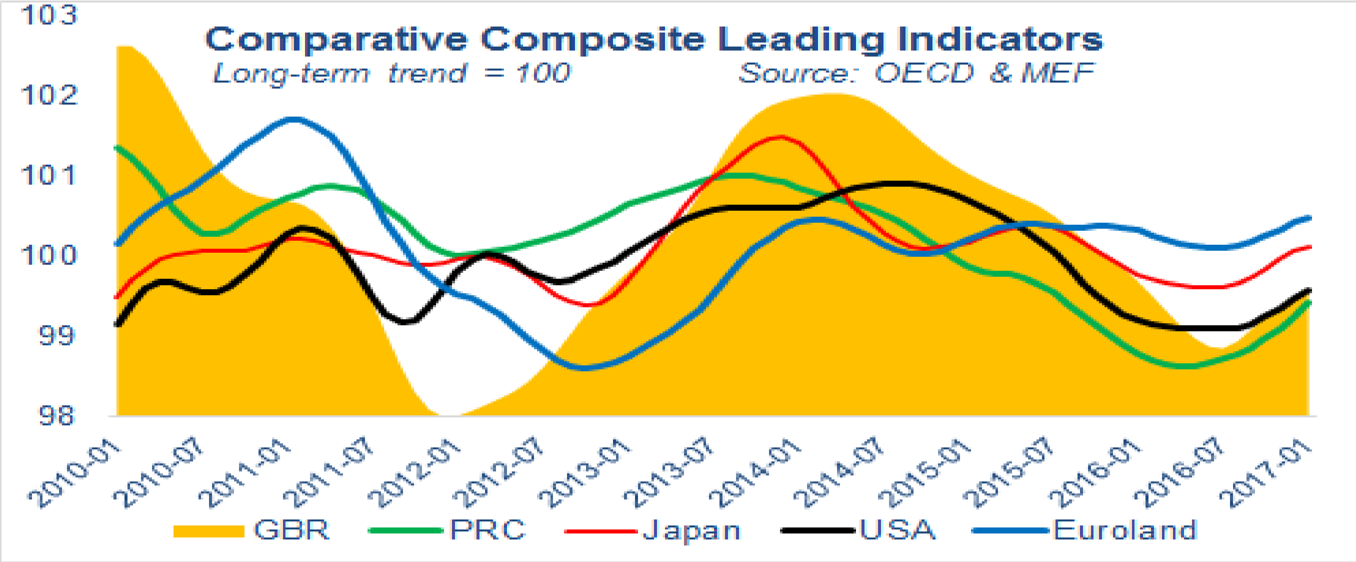


The Sterling effective exchange rate has fallen 10.4% since the Brexit referendum and has contributed to tightening inflationary pressures, with the CPI reaching 2.3% in February, the strongest since September 2013. According to official data, producer input prices have risen 19.1% over the same period, and has fed through into producer output price which have increased 10.7%. Transport, especially fuel prices were the principal contributory factors. Similar price pressures were evident in the recent PMIs, and remained acute in March. Manufacturing, construction, and services PMIs all reported increases in input prices in March. These pressures were evident in the regional PMIs, with input and output costs rising faster in the Midlands than the UK overall, and many businesses reporting that squeezed profit margins were causing them to pass on costs to clients.

The triggering of Article 50 seems to have had minimal impact on Sterling thus far, with markets appearing to have priced in the beginning of the Brexit process. Since November 2017 it seems to have settled into a new trading range between US$1.21 and US$1.27. However, Sterling fell following the news of weaker than expected output in the production and construction sectors in February – notably energy production.



The lower trading range of Sterling was also cited by businesses as a reason for increased demand from abroad, as the price competitiveness of UK products is increased and there is anecdotal evidence that accelerating import prices is contributing to some substitution effects. The region saw an increase in exports to both the EU and the Non-EU from 2015-2016, however the overall trade deficit worsened. This was mostly as result of weaker performance in the EM, as the WM merchandise trade balance improved from 2015-2016, including the surplus the WM has with Non-EU countries. Given the absence of regional services trade data, it is difficult to calculate the scale of regional services sector exports but these are estimated to equivalent to 40% of regional merchandise exports.



Recent comparative composite leading indicators, produced by the OECD, suggest that Britain's output performance is easing behind that of its principal competitors. This is reflected in the contraction in February's official production and construction data, coupled with evidence of slower housing price growth. More vigorous prospective growth can only be envisaged if issues such perennial productivity under-performance is effectively tackled, hopefully through the government's new policy initiative, the Industrial Strategy. Since 2008, average output worker has been becalmed at an average growth rate of 0.3% per annum. Greater public capital investment in infrastructure would seem to be key, particularly for manufacturing and related services-sector activity. It is notable however, that productivity performance has been particularly weak in banking, telecoms, energy, and management consultancy, with these sectors accounting for two-thirds of the weakening. PMI-based data on productivity, particularly at a regional level, seems to contrast with official output per worker and needs further investigation.

Latest official data recorded output per hour increasing by 0.4% in the final quarter of last year, following equivalent growth of 0.2%, 0.3% and 0.3% in the three preceding quarters of 2016. Within the G7, Britain ranks fifth in terms of output per hour productivity, and was estimated to be some 16% lower than the G7 average.

Quotes:

Professor Julian Beer, Deputy Vice-Chancellor at Birmingham City University, commented: “Despite some softening of performance, today’s regional PMIs releases continue to register positive trends, notably in new business orders, although tightening prices pressures continue to be a concern. Concessions offered by China to the US over trade will hopefully prove a more lasting impact that recent political factors and suggest further new post-Brexit opportunities, although the outlook for EU Brexit negotiations continue to look difficult.”

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Notes:

Birmingham City University:

Birmingham City University is a dynamic, business-engaged institution. As a substantial employer with over 2,000 staff and through the provision of graduate talent, research and knowledge transfer, we contribute around £180 million to Birmingham's gross domestic product (GDP).

The university works with in excess of 5,000 businesses, regionally, nationally and internationally, with our courses informed by Industry Advisory Boards, where information about business needs are reviewed and skills challenges are discussed. In 2015 we launched Advantage, the business growth service from Birmingham City University enabling organisations and individuals to get connected with knowledge, skills and money in business, innovation and enterprise.

We have extensive sector linkages providing detailed intelligence and input into future innovation, driving thinking around smart specialisation, the creative economy, advanced manufacturing and health-related life sciences. Through our work with partners such as the GBS LEP, WMCA, Science City, and Creative City Partnership, we take a lead on cross innovation, design and climate change. Innovation is at the core of our work. Working in partnership is at the core of our approach to business.

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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