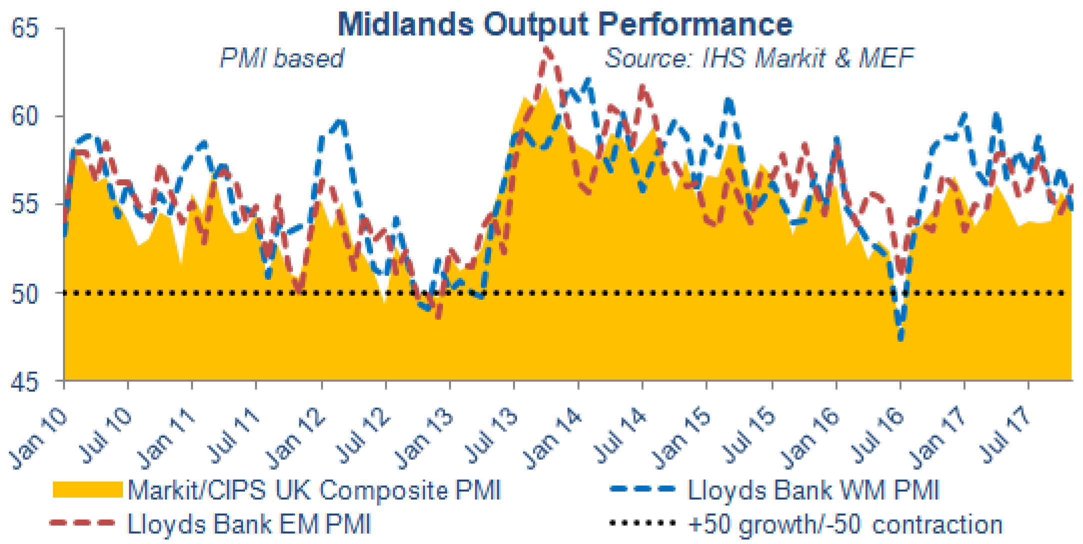
Regional Monitor December 2017

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

Days since Article 50 activation: 259 **Remaining Brexit Negotiating Days: 45?**

- The EM PMI recorded 56 in November, up from 54.6 in October. WM eased to 54.6 from 57.2 in October.
- Overall UK PMI was 54.9 in November from 55.8 previously.
- The need for extra capacity led to increased labour demand in the Midlands.
- Price pressures remain, with many firms passing on higher input costs to customers.
- Brexit negotiators recommend to European Council that sufficient progress has been made to move to next more technical (difficult?) phase, including preliminary political phase of negotiations.

The Lloyds Bank EM PMI showed an increase in business activity, as it rose to 56.0 in November, up from October's 54.6. However, in the WM, output softened to 54.6 in November from 57.2 previously, although still above the 50 growth/contraction mark. The UK PMI also showed a softening performance, down to 54.9 from 55.8 in October. This is the first time WM performance has been slower than that in the UK since August 2016.

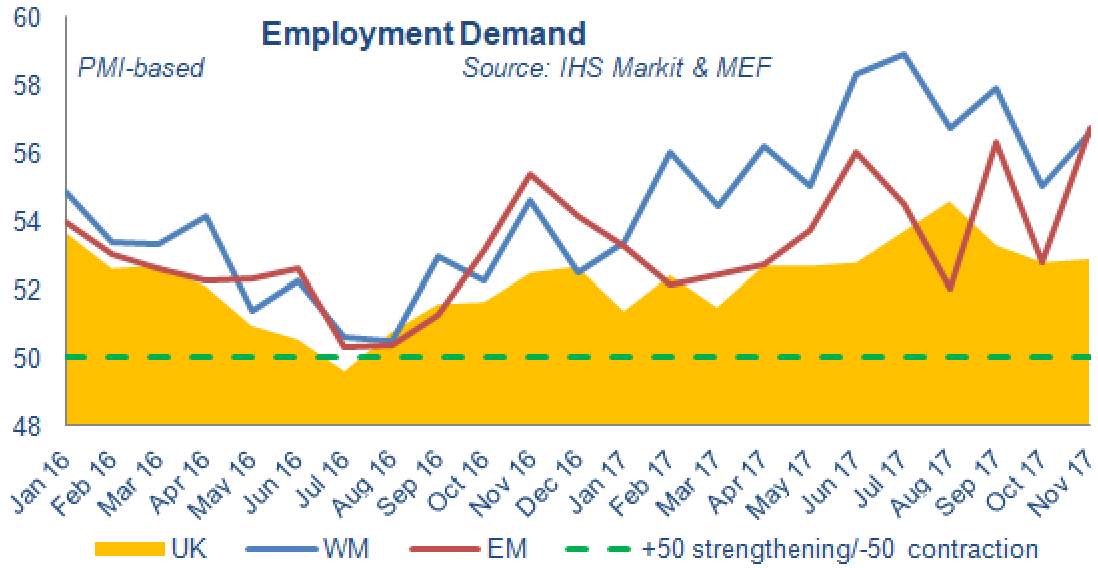


The three UK sector PMIs reflected this slightly mixed performance, with manufacturing showing an increased pace of growth in November, and a recovery in construction output, although the services sector saw a slight slowing of growth.

The ONS short term indicators for October have also been published; they reflect the PMI figures for October in that they show growth in production, with manufacturing – especially automotive production - particularly strong, which is positive for the Midlands. Construction output was more subdued – as it has been in recent PMIs – however future work has been buoyed in the third quarter by High Speed 2 contracts.

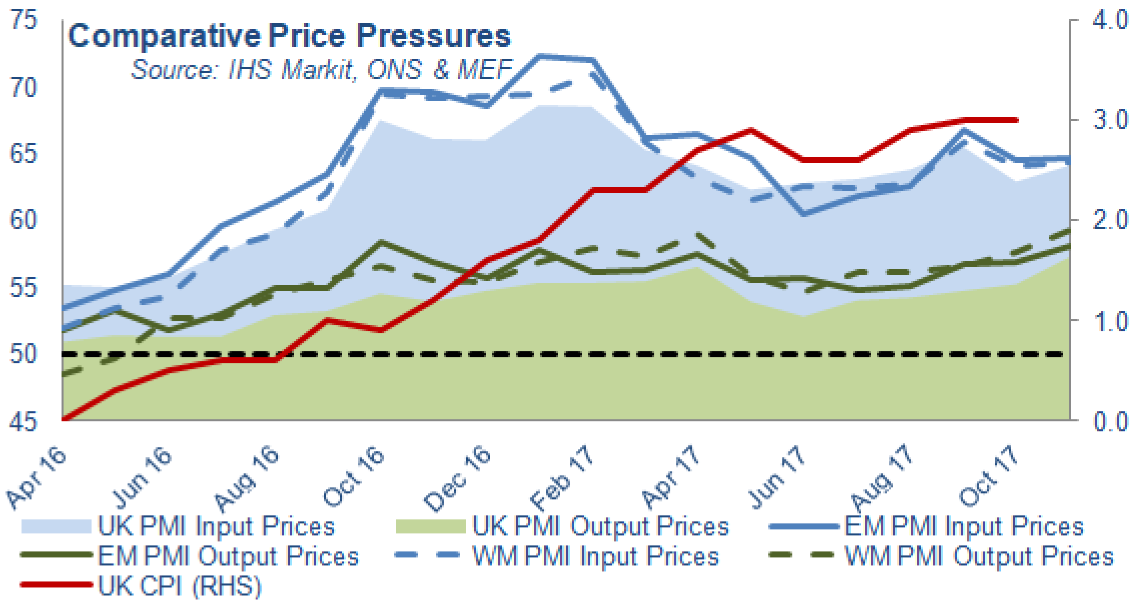
Julian Beer, Deputy Vice-Chancellor at Birmingham City University commented: "Although output is faltering across the region, activity remains locked in positive territory. As Brexit negotiations look set to move into a more technical phase, it will be vital the region's economic and trade interests are effectively represented."

Labour demand in the Midlands continued to grow above that of the UK overall, with businesses in the EM and the WM reporting that employment demand was stronger in the manufacturing than the services sector, and many firms reported an increased need for new capacity. Business outstanding increased in the EM, in line with faster growth in new orders, it also grew very slightly in the WM, although some firms reported that slower growth in new business had allowed some backlogs to be cleared.



The IHS Markit report on jobs for November reported the fastest growth in new placements in the Midlands of all UK regions, with pay also accelerating in the Midlands. However, the number of candidates available for full-time work declined in the Midlands, as it did across the whole of the UK, in contrast with official labour market statistics for the region, which showed that the West Midlands had the joint highest unemployment rate in quarter three, at 5.5%. This could be an indicator of the skills shortages in the region.

Price pressures continued to rise in the region in November, with both EM and WM reporting faster rises than the UK overall, although the difference was less market than it has been previously. Businesses across the Midlands reported increasing commodity prices and exchange rate fluctuations as the main cause for increased prices.



These higher input costs are being passed on to consumers through higher output prices, which accelerated in November in the Midlands, reflecting a sharp increase in the UK overall. There were faster rises in output prices for manufacturers than for services firms.

This was reflected in the UK sector PMIs, with manufacturing and service sector firms reporting increases in cost pressures. In particular, manufacturers reported commodity prices, exchange rate pressures and supply chain constraints leading to higher prices, however they also noted their increased price power, due to strong demand, allowed them to pass more of these costs on to customers. Services firms noted increased costs for food, fuel, imported items and staffing costs, and many were forced to pass these costs on to customers. In contrast, construction firms saw abatement in cost pressures, with exchange rate pressures being less intense.

Business outlook in both the EM and the WM remained positive in November, although subdued compared to previous years. This was largely attributed to acquisition of new clients, new products and, in the East Midlands, higher order volumes.

Brexit Update: *bonfire of delusions*

Friday 8th December saw Jean-Claude Juncker, President of the European Commission and Donald Tusk, President of the European Council, in pre-dawn negotiations (before European markets open) with Prime Minister May, agree that they could advise the European Council (of Minsters, meeting December 14th-15th) that British-EU negotiations had made sufficient progress to procced to the next phase, including preliminary trade negotiations. However, and provided the Council endorses the assessment, Michel Barnier, European Chief Negotiator for the United Kingdom exiting the European Union, immediately dampened widespread relief that victory had seemingly been snatch from the jaws of defeat, by implying that trade negotiations may not commence until March 2018 at the earliest, and some six months before the EU's October deadline for the conclusion of negotiations.

Moreover, the further unfolding of the Brexit negotiations takes place in a much less favourable global environment. Notably a more aggressive approach by the USA toward international trade policy toward more bilateral approaches, advocating a radical overhaul of the WTO and its system of arbitration. This month's Buenos Aires WTO Ministerial Summit has already revealed the extent of the divergence between the USA and other WTO members. However, this has not precluded a number of national governments, both WTO and non-WTO, expressing concern that Britain should not be able secure more advantageous trade access, once it leaves, than they themselves enjoy. Similarly, EEA members, such as Liechtenstein, have raised similar objections.

Furthermore, the European Council may have more pressing concerns than Brexit, such as the administration of justice and EU obligations in Poland and to a lesser extent elsewhere in Central Europe. Whilst calls by German SPD Leader Martin

Schulz, as the Party enters government coalition talks with Angela Merkel's CDU/CSU, for a United States of Europe by 2025 (with those falling to sign-up exiting the EU), may re-energise President Macron's EU reform programme but fuel tensions between the core and periphery. It may also add fresh impetus to anti-Federalists within Britain and a fresh dimension to Britain's exiting process.

In terms of Friday's negotiations, substantive progress appears to have been made with regard to four negotiating areas:

- protecting the rights of Union citizens in the UK and UK citizens in the Union;
- the framework for addressing the unique circumstances in Northern Ireland;
- the financial settlement;
- progress was also made in achieving agreement on aspects of other separation issues.

Despite of the political optics suggesting that a compromise has been reached "requiring give and take from both sides", close reading of the documentation suggests that the UK has moved considerably further from its original position than has the EU. Moreover, it now appears clear that very substantial portions of EU legislation will continue to apply to Britain, and for at least 8 years after Brexit.

Specifically, with regard to EU citizens residing in Britain, the Government's position paper initially sought to provide "a new 'settled status' for EU citizens who arrive before a cut-off date, which is yet to be specified and will be agreed as part of the negotiations with the EU". Britain has now acceded to the EU's request that the date in question should be the date of withdrawal from the EU. Substantial portions of the technical agreement rely on a number of EU directives and in all cases Britain has agreed that EU law concepts used in Withdrawal Agreement is to be interpreted in line with the case law of the Court of Justice of the European Union (CJEU)".

Similarly, the agreement specifies that "the CJEU is the ultimate arbiter of the interpretation of Union law", meaning that in any case where a Directive is cited (which occurs frequently in the agreement on citizens' rights) this will mean a continuing role for the CJE (ostensibly one of the Government's "red lines" in negotiations) for many years to come. A substantial portion of other rights will also be granted to EU citizens who reside in Britain, including the right to be joined by a spouse or partner (providing the partnership begins prior to the withdrawal date).

These rights are greater than those granted to British citizens, who must demonstrate a minimum income in order to bring in a spouse from outside the EEA.

In the case of Northern Ireland, the UK has committed that "in the absence of agreed solutions, the United Kingdom will maintain full alignment with those rules of the Internal Market and the Customs Union which, now or in the future, support North-South cooperation, the all-island economy and the protection of the 1998 Agreement." In effect, this allows the EU a veto over which rules and regulations pertaining to the Internal Market and Customs Union Northern Ireland might be able to derogate from.

As an EU member, Ireland is bound to ensure that *all* goods or services that enter into Ireland are consistent with EU regulations. In order to police this, some kind of customs border must be necessary except in the case where Northern Ireland maintains complete regulatory alignment with regard to goods. Moreover, it would not be unreasonable to argue that full ongoing regulatory alignment with regards to services would support the all-island economy and hence must be maintained.

Paragraph 50 of the same agreement, however, states that "the United Kingdom will ensure that no new regulatory barriers develop between Northern Ireland and the rest of the United Kingdom, unless, consistent with the 1998 Agreement, the Northern Ireland Executive and Assembly agree that distinct arrangements are appropriate for Northern Ireland. In all circumstances, the United Kingdom will continue to ensure the same unfettered access for Northern Ireland's businesses to the whole of the United Kingdom internal market." In other words, what is true for Northern Ireland must also be true for Great Britain (except in cases where Stormont explicitly accepts regulatory divergence).

Thus Britain has, in effect, agreed to maintain those EU rules and regulations pertaining to goods (and possibly services) that the EU (and Ireland) specifies that it must. The current position of the British Government appears to be that "regulatory alignment" would only apply to the six "allowable areas" of transport, tourism, education, health, environment and agriculture covered under the 1998 agreement. However, in practice, it is difficult to see how a "soft border" could only cover these areas to the exclusion, say, of manufactured products. One could thus be left in the situation whereby a truck could in theory cross a border without the need for checks, but not its contents. Hence, the scope of regulatory alignment could end up being much broader, as alluded to above. As such, the British will no longer have a vote or veto on the development of those rules but must nevertheless implement them.

With regard to the financial settlement, Britain will continue to contribute to the EU budget in 2019 and 2020 as if it remained a member and will contribute its share of any outstanding budgetary commitments as of the end of that year. Moreover, Britain will continue to contribute its share of any liabilities incurred prior to leaving (including a proportional share of loans and pension payments etc.) The financial settlement will be paid in € (meaning that Britain is open to exchange rate risks that may arise due to market perceptions of a poor deal in future). It is estimated that the estimated commitments currently total in the region of €40-€55bn.

In short, Britain has currently agreed (which may be heavily revised in the final agreement notwithstanding) to pay a substantial financial settlement to the rest of the EU in order to cover its remaining liabilities as a former member state. In addition, the UK has agreed to a substantial role for the CJEU, particularly regarding citizens' rights. Finally, it appears that the British Government has agreed to maintain substantial regulatory alignment with the EU in order to protect the Good Friday Agreement and ensure continued support of the Democratic Unionist Party in parliament. As such, Britain will continue to have many of the responsibilities of EU membership with few of the rights. In particular, some British citizens may be concerned that they will no longer have a meaningful vote over many of the rules and regulations that will continue to apply to them in a post-Brexit era.

Given this, it is unclear what the domestic political ramifications are likely to be. There is a significant portion of the governing Conservative party (as well as in the country at large) for whom wholesale regulatory alignment and restrictions on the UK's customs policy is likely to be anathema. Regulatory alignment on agriculture in particular could prove to be a sticking point for Brexiteers keen to push for trade "deals" with the US or New Zealand – although notably these countries have formally objected to the WTO regarding the proposed revised position of Britain and the EU within the WTO. Equally, it is unclear what "distinct arrangements" for Northern Ireland the DUP might ultimately be willing to tolerate (particularly given that a number of powers are already devolved to the currently suspended Stormont). Finally, the potential for any privileged role for a reconvened Stormont raises very real questions for the Midlands, as well as other regions such as the devolved administrations and London), where it is likely to strengthen both Unionist and pro-independence voices seeking similar privileges.

In the meantime, the EU has announced that it has completed negotiations for a trade deal with Japan. Issues around investor protection notwithstanding, in particular the deal means that the EU will remove import tariffs of 10% on Japanese cars and the 3% tariff on car components – a move that will be of significance to Japanese car companies with production facilities in Britain (such as Toyota, Nissan and Honda), contemplating where to reinvest in their respective next production model cycles. The EU is also looking to gain free trade agreements with Mexico and the Mercosur group of Argentina, Paraguay, Uruguay and Brazil.

Ends

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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.

The last month has seen the Centre consolidate and expand its activities, with a view to making a continued contribution to debate and thought leadership on the subject, with a research examining the potential for trade with Commonwealth countries, employment law implications and future humanitarian relief (particularly in light of recent natural disasters in the Americas) . Forthcoming work will include further analysis on potential future trade links with Commonwealth countries, particularly focussing on India, Australia and Nigeria. In addition, the Centre plans to enhance its communications capabilities and web presence with a series of regular podcasts by academic experts. The "CBS" roadshow planned for November and December will take us across the country in an effort to identify and understand people's current concerns around the Brexit process and what it means for them. Finally, an early "heads up" for the CBS Annual Conference next March, where we can confirm keynote speakers including Professor Patrick Minford of Cardiff University, and Professor Vernon Bogdanor FBA CBE of Gresham College.

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.