Midlands Perspectives

The Midlands: the engine of growth *July 2015*

Overview

- Smaller but more activist state
- Adoption of the "Living Wage" shifts focus to productivity
- Midlands Connectivity key to boosting output performance
- Regional growth remains vibrant, forecast to be stronger than national
- Export performance concentrated in two key sectors:
    - *Machinery & Transport Equipment*
    - *Power Generation*

Budget

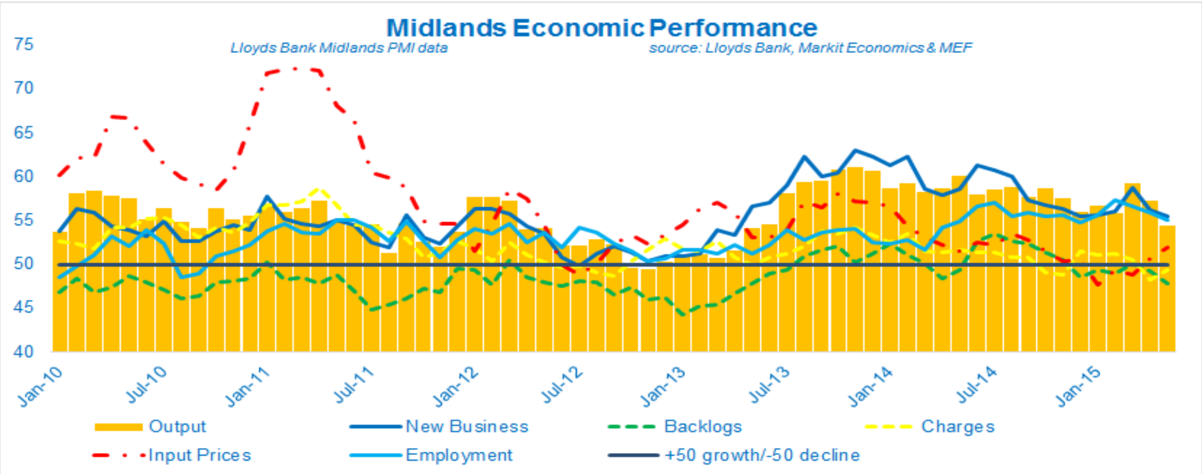
The July Budget, and associated "Fixing the Foundations" economic strategy paper, announced by George Osborne this month, place productivity growth at the heart of the new government's programme. With IMF forecasts of a primary fiscal surplus by 2017, the slight improvement in the fiscal climate has enabled a slackening of the pace of austerity implementation. However, and despite an increase in the overall tax burden, the thrust of the budget remains one of creating a smaller, albeit more activist, state with expenditure forecast to fall to 36% of GDP by 2018 – a level not recorded since the turn of the century. The real GDP growth forecasts, on which the budget is based are comparatively robust, 2.4% this year, a slight easing to 2.3% next year and 2.4% in the subsequent years up until 2020. These forecasts are nevertheless, vulnerable to a number of external factors, in particular Greece, Ukraine, China, oil prices and something called the business cycle - with the current recovery maturing into its sixth year. Indeed, with price pressures becalmed (June annual CPI was 0.0%) there is some evidence for the fragility of performance.

Whilst the actual impact of the budget, notably and somewhat controversially that of the welfare cuts, is still being assessed, the budget attempts to broaden the political debate from just austerity, towards policies encompassing the creation of a higher wage, lower tax, lower welfare society. The sequestration of the title "Living Wage", replacing the "Minimum Wage" as the labour market floor, may yet only prove to equate to a minor shift in actual remuneration for the lower paid. However, it may subsequently ensure that the context of low pay is now set within the terms of what constitutes a realistic wage structure in an advanced economy. With the emphasis on productivity, the Living Wage is not the only factor that will increase pressures on the business sector, measures such as the apprentice levy, incentives to enhance labour force skills and boost capital investment are yet further demands. The government strategy would appear to be counting on enterprises to invest in training and provide the necessary technology and equipment to facilitate output and productivity growth, rather than reduce the labour force through automation. Time will tell if the planned reduction in corporation tax and easing of NI contributions for some SMEs will assuage business concerns and incentivise higher-value job creation.

Further devolution is being extended not only to the "Northern Powerhouse", but across England, including what is termed the "Midlands Engine for Growth", and the strategy of Midlands Connect, with its focus on transport as a key to boosting productivity, endorsed with funding. This will complement the greater responsibilities in the process of being granted to the devolved national administrations.

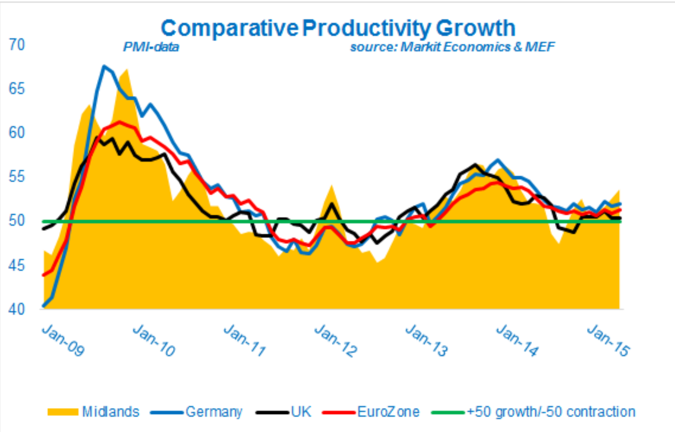
Recent Regional Output Performance

Recognition of the inadequacy of national statistics, if not of the inaccuracy and paucity of regional data, by the government was an important subscript to the Budget with the announcement of an independent review to assess the UK's future statistics needs, in particular relating to the challenges of measuring the modern economy.

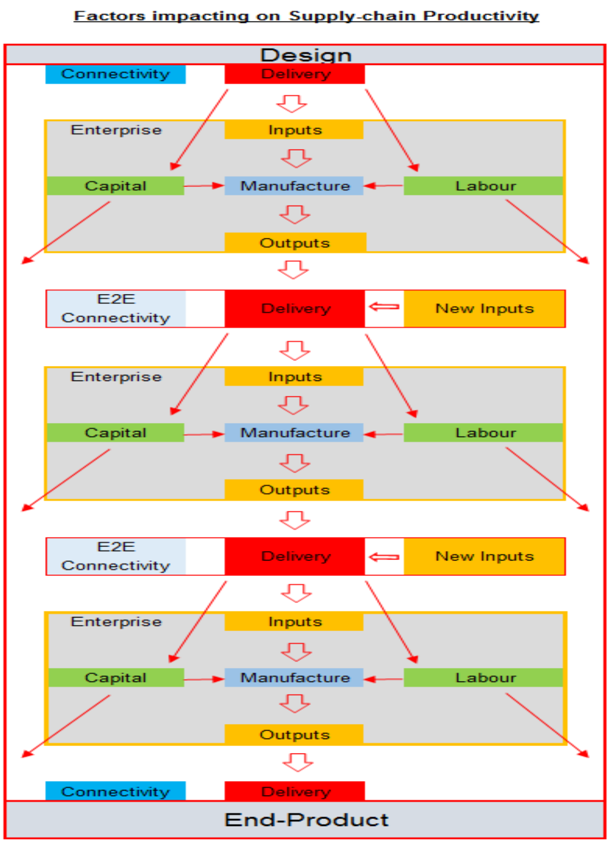


The introduction of more market-orientated, timely regional statistics would certainly inform greater understanding of the dynamic of the Midlands economy. According to the latest PMI-based data, the regional economy continues to perform robustly, and generally has registered a stronger performance over recent years than that achieved nationally. This growth has been built on the continued strength of new business orders coupled with employment growth, with both input prices and charges falling through the course of 2014 and into 2015, although in recent months prices have started to firm. A significant build-up of work backlogs last year has been progressively eroded this year, although this may reflect weakening of demand, notably in the EU.

Regional Productivity Performance

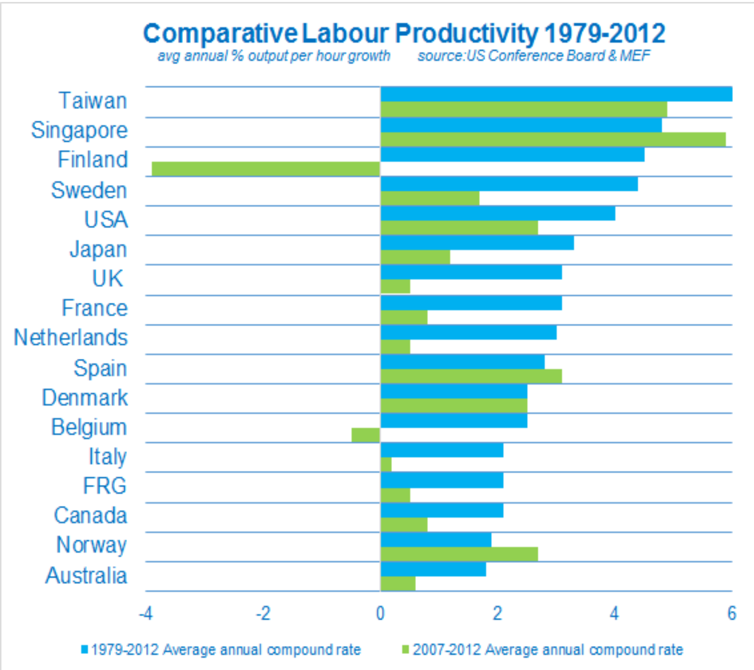


With the strength of local manufacturing, and the associated service-sector enterprises, the local economy retains an evident dynamism. Whilst, as "Fixing the Foundations" highlights, UK productivity levels continue to substantitaly lag behind its main competitors. However, in terms of productivity growth rates, the Midlands continues to keep pace with the UK, the Eurozone and indeed Germany. To narrow the productuvity gap therefore, the region will need to substantially increase rates of growth. The Foundations strategy paper offers a 15-point action plan designed to boost productivity, based on two key aspects: encouraging long-term investment and fostering a dynamic recovery. Locally, the most immediate impact is the financial support of Midlands Connect, and the potential stimulus that impoved connectivity could provide.



Rather than analyse productivity within the context of a single enterprise, for the Midlands it is perhaps more pertinent to examine productivity within the parameters of the Supply-chain, and especially Enterprise-2-Enterprise (E2E) connectivity. Given the predominance of small and micro-enterprises within the local supply-chain, the production of a single product - a piston, a bearing or an aileron – may involve a number of enterprises and thus the inputs involved in the manufacture may transit these enterprises a number of times between the design stage and the final end-product. Providing effective local connectivity infrastructure would obviously support an uplift in productivity. Similarly, reducing delivery times would facilitate greater competiveness internationally.

Recent data provided by Oxford Economics, indicates that manufacturing productivity grew by 6% over the period 2010-15, and are now forecastig the sector could increase by as much as 16% over the period 2015-2020. This would suggest a period of further robust growth for the region. In contrast, research by Allianz suggests that in Germany there has been a pronouced slowdown in the pace of labour productivity growth in recent years, easing to 0.9% per annum in the period 2005-12. Indeed, over the period 1979-2012, labour output data provide by the US Conference Board, indicates that the UK was one of the strongest perfromers of the larger EU economies, with an annual average rate of productivity growth of 3.1%, compared with Germany where the growth achieved was 2.1%. Given that the economic growth rates of the respecitve economies over this period were not too disimilar, it would suggest that the reasons for the Federal Republic's surge in export growth is not simply a matter of output competitiveness, but of other factors, such as foreign exchange rate policy and commitment to sustaining and enhancing international connectivity, and enabling increased penetration of global supply-chains.



International Merchandise Trade Performance

Top Twenty Midlands Merchandise Trade Sectors						
2014						2014
	£ '000	% of total	Rank	% of total	£ '000	
Total Merchandise Exports	48,556,866	100.00		100.00	57,340,720	Total Merchandise Imports
Road Transport	16,768,535	34.53	1	11.67	6,689,741	Road Transport
Power Generation	9,110,059	18.76	2	10.89	6,244,217	Petroleum Products
General Industrial	2,832,135	5.83	3	8.31	4,763,909	Power Generation
Electrical Machinery	1,836,596	3.78	4	5.60	3,208,644	Electrical Machinery
Specialised Machinery	1,710,118	3.52	5	5.20	2,983,586	General Industrial
Other Metal Manufactures	1,499,852	3.09	6	4.59	2,632,516	Apparel
Instrumentation	1,163,613	2.40	7	3.83	2,194,002	Other Metal Manufactures
Other Miscellanous Manufactures	1,092,277	2.25	8	3.76	2,155,611	Other Miscellanous Manufactures
Non-ferrous Manufactures	858,581	1.77	9	3.63	2,082,811	Specialised machinery
Other Transport	842,163	1.73	10	3.16	1,809,225	Iron & Steel
Apparel	807,306	1.66	11	2.55	1,460,594	Vegetables & Fruit
Iron & Steel	731,724	1.51	12	2.39	1,368,645	Non-ferrous Manufactures
Metal ores (incl. scrap)	608,624	1.25	13	2.30	1,319,470	Instrumentation
Rubber Products	561,129	1.16	14	2.22	1,271,713	Rubber Products
Non-metallic Manufactures	538,585	1.11	15	1.76	1,010,041	Meat
Essential Oils (incl. perfume)	521,673	1.07	16	1.71	983,372	Furniture
Office Machines	444,844	0.92	17	1.60	916,631	Non-metallic Manufactures
Medicinal & Pharmaceuticals	439,732	0.91	18	1.50	861,071	Textile yarns
Telecomms (incl. sound)	429,953	0.89	19	1.45	831,077	Footwear
Other Chemicals	368,473	0.76	20	1.39	796,169	Telecomms (incl. sound)
Other Merchandise Exports	5,390,894	11.10		20.50	11,757,675	Other Merchandise Imports
						source:HMRC & MEF

Notwithstanding the dramatic surge in merchandise exports over the course of the recovery (close to 50% between 2008 and 2014), the Midlands still continues to record a substantial merchandise trade deficit overall. Whilst these figure are for gross exports rather than net exports (which would give a more accurate indication of the domestic value-added component of exports and exclude the re-export component), the 2014 merchandise trade deficit is equivalent to £8.8 billion, or 4.4% of total regional GVA. Overall merchandise trade is the equivalent of over half of total GVA output, reflecting the openness and global integration of the regional economy. In the absence of realistic regional services trade data, it is not possible to evaluate the real position of the region viz-a-viz the global economy. A significant import is that of petroleum products, indicating that more efficient sustainable energy utilisation could have a significant impact on manufacturing costs and export competitiveness.

The top twenty export sectors contribute close to 90% of all exports, with Road Transport (35%) and Power Generation (19%), providing over half of all exports – a crucial export dependency, that needs to be addressed in terms of both sustaining current growth patterns but also facilitating greater export product diversity. Connectivity again a key factor in achieving both. Given the importance of servitisation revenues to many, if not most of the region's major manufacturers, services exports can be assumed to be significant, with international connectivity a key driver in boosting performance of this sector.

Midlands Basic Data

2014 (or estimates for)	Total	% of England		Total	% of England
Land Area (sq km)	28,360	21.7	Population	10,273,400	18.9
GVA (£ bln)	199,081	15.3	GVA £ per capita	19,378	80.4
Economically Active	5,136,000	18.5	GVA £ per EA persons	38,762	82.9
GDHI (£ bln)	161,334	16.8	GDHI £ per capita	15,587	87.4
Qualifications					
GSCE (5 A*-C, incl M&E)	54.5	% of age cohort			
Degree Level Residents	28.30	% resident population			
	Total	%			
Businesses	329,650	100			
Micro (0 to 9)	289,125	87.7			
Small (10 to 49)	33,345	10.1			
Medium-sized (50 to 249)	5,830	1.8			
Large (250+)	1,350	0.4			*source: ONS, NOMIS & MEF*

This is the second in our new series of *Midlands Perspectives* reports on the comparative performance, international competitiveness and future prospects of the Midlands. Comments on how we could develop new perspectives on the regional economy are welcomed – we aim to create a dialogue rather than a monologue. info@midlandseconomicforum.co.uk

Report Authors:

Paul Forrest, Head of Research

Samuel Rooth, Research Assistant

Disclaimers

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.

West Midlands Economic Forum
8 Beaufort Way, Aldridge, WS9 0HJ
info@midlandseconomicforum.co.uk
www.midlandseconomicforum.co.uk
Registered in Cardiff, number: 07025784.