November 2015

Midlands Perspectives

The engine of growth

This edition sees the launch of the IDEA – MEF economic model. The model is designed to give a perspective of how the regional economy is currently performing and provides a forecast of potential future trends over the next five years. The design of the model is a collaboration between IDEA and the MEF, drawing on the latest available official data, the Purchasing Managers Indices produced by Markit Economics and from global commentators such as the IMF, OECD, World Bank and Bank of International Settlements.

IDEA - MEF Output Model: Midlands Projections

	2010	2015(e)	2020(f)
GVA (£ billion)	182.46	223.99	291.06
GVA growth % (nominal GVA £)	5.60	5.03	5.56
GVA (as % of total UK)	13.27	13.52	13.94
GVA per capita (£)	18,115	21,572	27,223
GVA per worker (£)	39,584	45,989	57,475
Exports as % of GVA	19.2	22.5	28.5

Source: ONS, NOMIS, IMF, HMRC and MEF

Output in the Midlands is projected to expand at a robust pace over the next five years as the recovery grows in strength. The model predicts a steady improvement in the Midlands' relative economic standing, rising to represent approximately 14% of the total UK economy by 2020. This performance is based on continued vigour in the region's manufacturing sector, which is already visible in recent PMI data.

The West Midlands itself, is recovering from a slightly softer period in the second quarter, whilst the pace of expansion in the East Midlands is moderating somewhat but continues to outperform the UK. Looking forward, both parts of the Midlands look set to enjoy a strong fourth quarter.

PMI-based data provided by kind permission of

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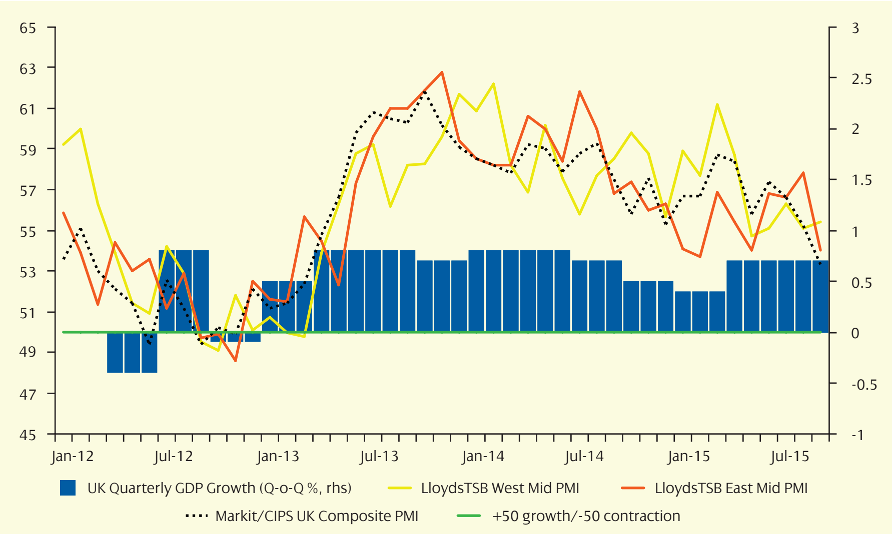
Midlands Output Performance



Source: Markit Economics, ONS and MEF

Overview

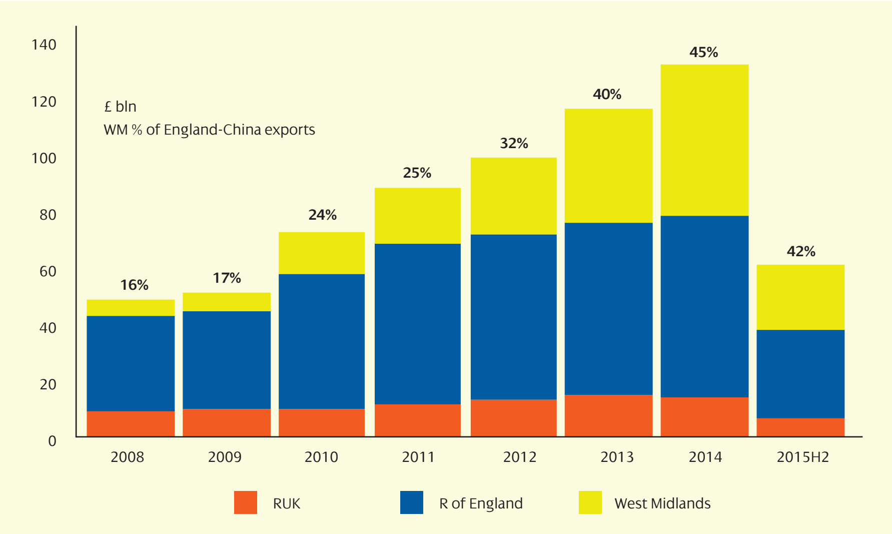
- The current account deficit, on the balance of payments (BoP), remains the most significant threat to the UK economy, particularly in a period of potentially weaker global performance and declining trade flows
- Economic weakness in China a major headwind, so far weathered well
- Overvalued sterling hampering exports to Europe
- Improving transport infrastructure key to competitiveness
- Midlands productivity growth outperforming UK average, especially in manufacturing

In the short term, however, a number of factors look likely to temporarily constrain output performance. Chief amongst these is the continuing slowdown in some of the Midlands' major export partners. After a softer period in 2016-17, however, the latter part of the decade should see a renewed acceleration as forecast global recovery gathers pace.

Global Context

China has rapidly risen up the ranks of export destinations for the Midlands, and as of 2014 was behind only the EU and US as the third largest export market. Indeed, the Midlands is the only UK region to run a trade surplus with the People's Republic. As such, the recent slowdown in the Chinese economy is a significant potential headwind for regional export demand. Nevertheless, the most recent PMI data suggests that the Chinese slowdown may be moderating somewhat. Furthermore, we see continued improvement in conditions in the Eurozone, with recent PMI data registering a modest but strengthening expansion. As the EU is the largest single market for exports from the Midlands, representing some 42% of the total in 2014, this is a positive development that should help to partially offset the impact of the Chinese slowdown on the Midlands economy.

UK Exports to China

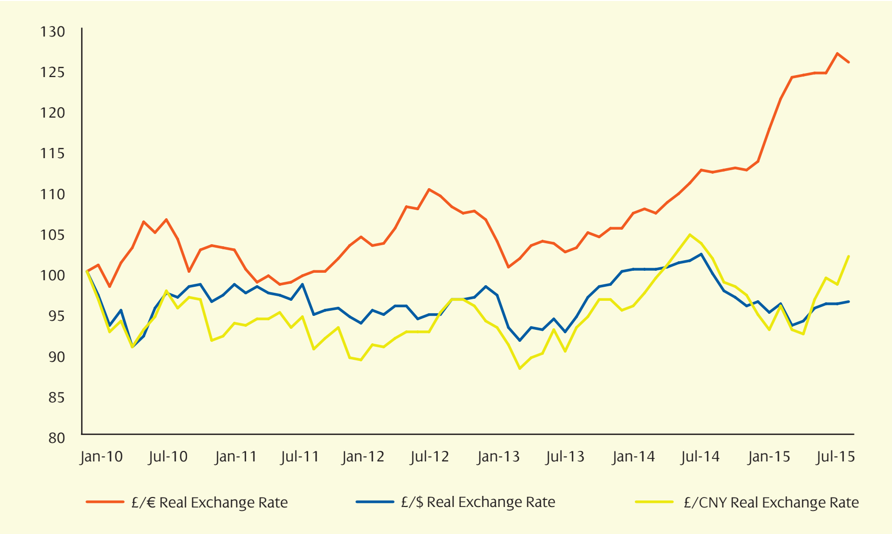


Source: HMRC and MEF

The manufacturing sector, both products and related services, and of the Midlands to exports offers a realistic route to reversing the current account deficit on the BoP. Primary and secondary income balances, on the BoP (primarily overseas investment income) have eased and the financial services contribution remain beleaguered - performance down over a third since the peak of 2007 – and in the changed global environment Midlands manufacturing-related exports offer a model for growth. Overall UK manufacturing exports, including services, were equivalent to 40% of total exports in 2014, compared to finance and insurance sectors which was equivalent to 8%.

Recent exchange rate developments are less favourable for exporters in the Midlands. According to MEF calculations, as can be seen, £ has strengthened substantially in real terms over the past 12 months, particularly against the euro. This can be largely attributed to the introduction of quantitative easing (QE) in the Eurozone.

Real Exchange Rates (Jan 2010 = 100)



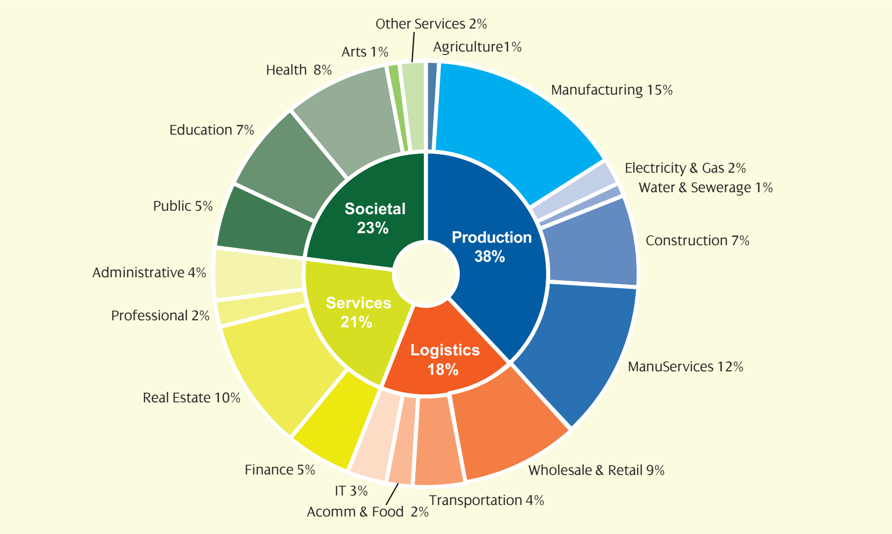
Source: ONS, BoE, ECB, US BLS, National Bureau of Statistics of China and MEF

Regional Trends

In contrast to this, domestic indicators are notably positive for the manufacturing sector, which bodes well for growth in the Midlands economy during the fourth quarter. A PMI reading of 55.5 (up from 51.8 in September) is consistent with a sharp acceleration of growth in the production sector (which makes up around 38% of the Midlands economy). The Midlands already appears to be one of the stronger growing regions in the UK during 2015 and the latest data accentuates this.

As noted in previous reports, transport infrastructure appears to be a significant constraint on output growth in the region. Whilst key manufacturing and service centres in the Midlands are located along major arterial routes (both road and rail) upgrading transport links within the Midlands represents low-hanging fruit in terms of facilitating growth and productivity improvements. Just-in-time manufacturing requires transport times to be both quick and predictable and a transport network that is operating at capacity with underdeveloped intra-regional links can struggle to deliver this.

Midlands Outsput Structure



Source: ONS and MEF

Improved East-West transport links would facilitate even greater collaboration between innovative SMEs and lead to a noticeable reduction in supplier delivery times. This is particularly important for both the production and logistics sectors, which between them make up over half of the Midlands economy.

Productivity in the Midlands

Since the financial crisis, productivity growth in the UK has lagged behind its G7 peers. Indeed, labour productivity has essentially stagnated over the past 7 years. Within the context of the UK, however, both East and West Midlands have emerged as two of the strongest regions, with productivity growth of 2% above the UK average in both cases since 2010. A particular bright spot as regards productivity growth in the Midlands has been the manufacturing sector, in which productivity growth was the highest of all regions in the UK and no less than 14 percentage points above the UK average.

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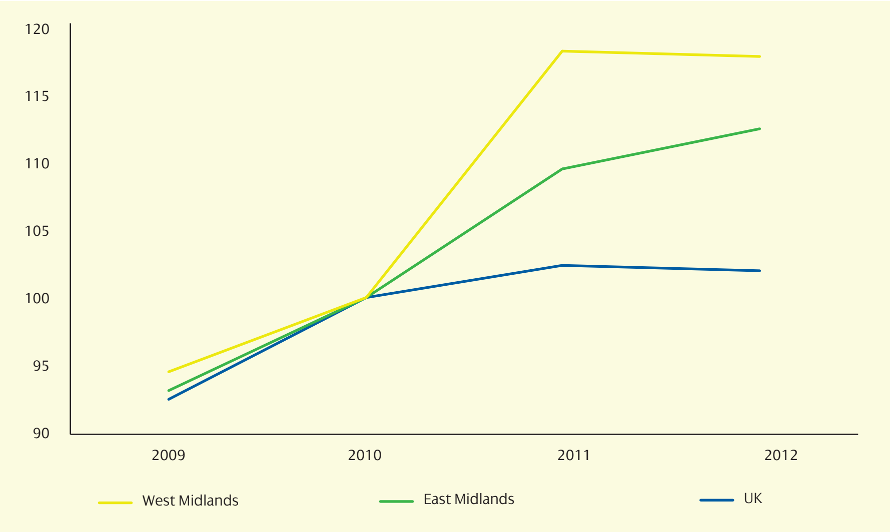
Manufacturing Productivity (2010 = 100)

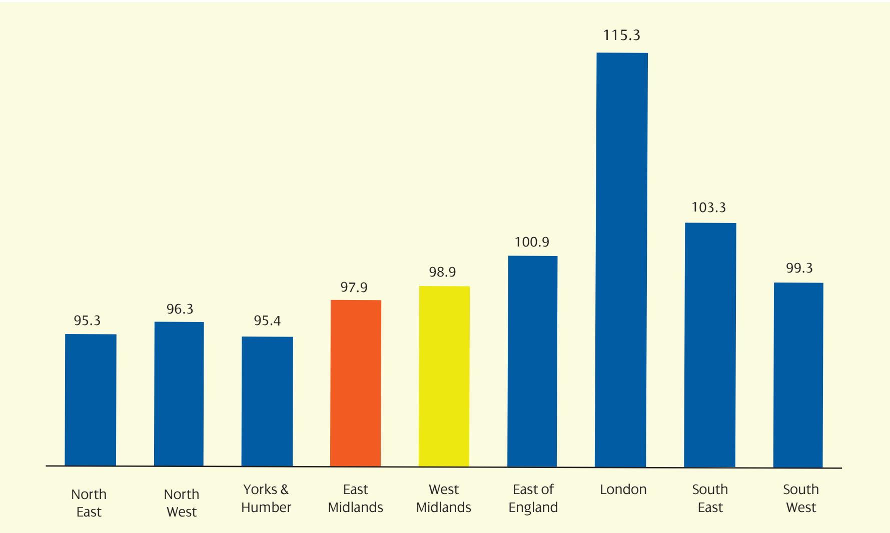


Source: ONS and MEF

Production and export of transport equipment is a particular point of specialism for the Midlands economy. This sector has seen consistently high productivity growth in recent years and offers a model for further diversification of the regional economy.

More generally, it appears likely that traditional measurements of labour productivity (GVA per worker and GVA per hour) overestimate productivity in London at the expense of the rest of the country. In the absence of ONS data on regional prices, real GVA is calculated using average prices for the whole of the UK. The end result is that when regions are compared, measurements of output in high-cost regions (most notably London but to a lesser extent the South East as well) are overestimated relative to those in lower cost regions (like the Midlands and North). Naturally, this carries directly across to measurements of productivity.

Relative Price Levels in English Regions (2013)



Source: D. Hearne, ONS and MEF

Midlands Basic Data

2013 (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	82.8
Economically Active	5,136,000	18.5	GVA per EA person (£)	38,762	82.9
GDHI (£ bln)	161,334	16.8	GDHI per capita (£)	15,587	87.4

Qualifications (2014 or estimates for)		
GCSE (5 A*-C, incl. M&E)	54.5	% of age cohort
Degree Level Residents	30.1	% of resident population

2015 (or estimates for)	Total	%
Businesses	356,270	100
Micro (0 to 9)	314,105	88.2
Small (10 to 49)	34,765	9.8
Medium (50-249)	6,000	1.7
Large (250+)	1,400	0.4

Source: ONS, NOMIS and MEF

The *Midlands Perspectives* series examines 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.

For further information:
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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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