Midlands Perspectives: EU Referendum Result- potential impact on the Midlands

1. *Overview*

The immediate impact of the EU Referendum results was collective shock amongst the political and economic establishment, which had been heavily in favour of retaining the current membership structure with the EU. In its immediate aftermath it has left the UK with a caretaker government until at least September, strengthening prospects for a November general election. It has also led to an imploded Official Parliamentary Opposition, a constitutional crisis in Scotland with a potential one unfolding in Northern Ireland and no clear concept of what exit from the EU will actually and ultimately entail. Understandably, financial markets have reacted negatively, with large falls in Sterling and global stock markets, contributing to growing concerns over the UK's creditworthiness – a combination of factors that could persist indefinitely – fuelling market volatility until there is a resolution of these issues.

Nevertheless for the Midlands there will be some short-term gains, particularly if Sterling settles within in a new lower trading band, and increased export competitiveness is achieved. However, into the second half of the year and further into the future the situation is much less clear. Much will depend on what EU exit agreement is finally realised, and whether it can be seen as beneficial to the Midlands export-orientated manufacturing and services sectors, as well as to the region overall.

2. *The Result*

The overall results reflect the increasingly fractured nature of UK politics, and the ramifications will permeate through the system for a number of years. While Scotland and Northern Ireland voted to remain by significant majorities, Wales and in particular England voted decisively to leave. Most notably the West and East Midlands recorded the largest percentage of votes to leave of the English regions.

Why electors voted in their each and varied ways is already the subject of much debate and in the Midlands the motivation for voting leave will have a particular impact on how the regional economy is developed in the future – there is a significant disconnect between the leadership of the business community and the general population. If it is simply a genuine difference over economic strategy the position is recoverable. If, however, it reflects a deeper alienation by large swathes of the Midlands community from the economic and political process then this is much more problematic, posing considerable challenges for regional bodies and institutions.

		Remain (%)	Leave %	Leave (millions)	Majority (%)	Turnout (%)
UK		**48.1**	**51.9**	**1,269,501**	**3.8**	**72.2**
Of which:	**England**	**46.6**	**53.4**	**1,921,410**	**6.8**	**73.0**
	Scotland	**62.0**	**38.0**	*-642,869*	*-24.0*	**67.2**
	Wales	**47.5**	**52.5**	**82,225**	**5.0**	**71.7**
	N Ireland	**55.8**	**44.2**	*-91,265*	*-11.6*	**62.9**
Memo Item:	*West Midlands*	**40.7**	**59.3**	**548,512**	**18.6**	**72.0**
	East Midlands	**41.2**	**58.8**	**442,443**	**17.6**	**74.2**

Source: Electoral Comission

3. Political Impact Nationally

The shock of the success of the Leave campaign has already had some immediate impact with the resignation of the Prime Minister, David Cameron, and the announcement that elections for a new Conservative Party Leader will be completed by the October Party Conference. The Prime Minister's position is perhaps not the only one that is untenable given the overwhelming “establishment” bias of the Remain campaign. The inherent difficulties of a Parliament (Commons and Lords) that is overwhelmingly pro-EU negotiating an exit deal that matches the sentiments of the Referendum result can already be seen.

The Prime Minster has also stated that it will be the responsibility of the next incumbent to trigger Article 50 of the Lisbon Treaty that provides for a two-year time period for negotiating exit. The lack of early progress toward framing a list of objectives to be achieved as a result of EU exit (and crucially its acceptability to the general public), the absence of a clear strategy or timetable for EU exit and the contemporaneous revisions necessitated to current UK legislation are problematic. Together with the fact, apart from establishing a policy unit in No. 10, few apparent steps toward forming an effective negotiating team have been taken, these all place the UK at an immediate disadvantage, which will add to market instability. In the meantime, President of the European Council Donald Tusk, has appointed Belgian diplomat Didier Seeuws to manage the day-to-day management of the severance negotiations (Seeuws is former Chief of Staff to European Commission President Jean-Claude Juncker), amidst calls by a range of EU leaders for immediate formal negotiations to commence accompanied by a collective refusal to countenance any informal discussions. David Cameron is to be excluded from the second day of this week's EU summit and the UK's EU Commissioner, Lord Hill has resigned. Similar tactics of isolation can be anticipated for UK MEPs and British members of EU bureaucracies.

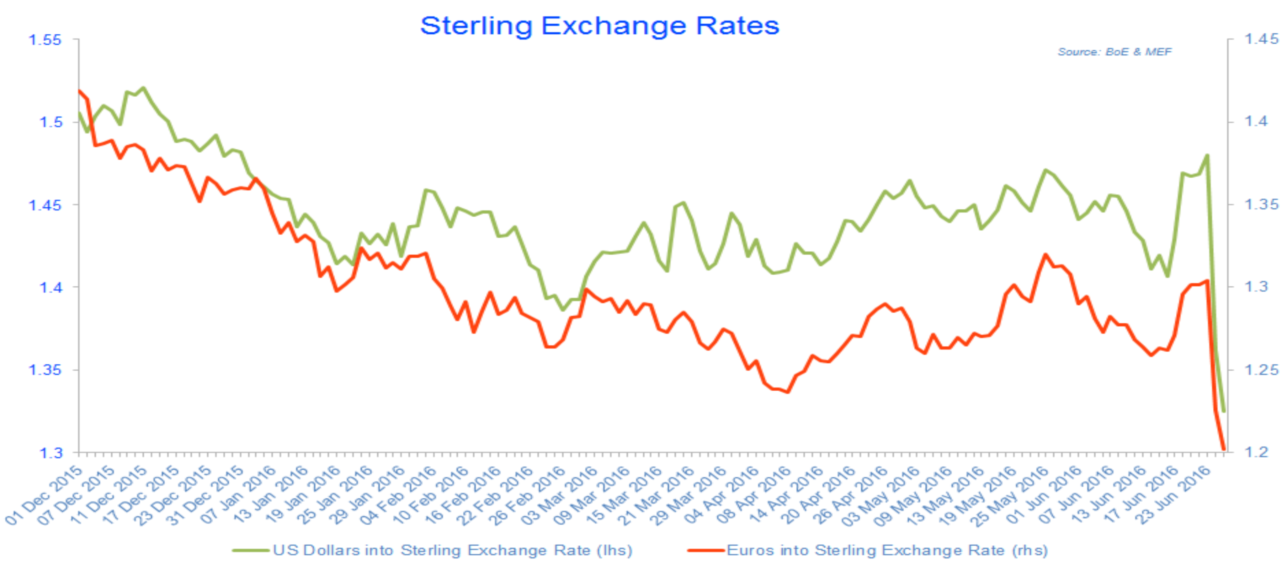
The Scottish result suggests that north of the border serious consideration will be given to launching a second independence referendum, whilst in Northern Ireland the result has emboldened Sinn Fein to call for a referendum on Irish re-unification, which suggests that the Good Friday Agreement may face renewed pressure. Additionally, all three devolved administrations appear to be calling for early renegotiations of their fiscal agreements with Whitehall, given that the existing ones incorporate EU funding flows – perhaps few had realised that the Barnett formula may need to be reset, which could have a further deleterious impact for the East and West Midlands fiscal settlements and already weak official funding flows.

The results in Wales, and indeed the Midlands and North of England, pose considerable questions for the Labour Party and its relationship with these regions given the juxtaposition between the leadership's advocacy of Remain and the actual vote results. Amidst the continued strengthening of UKIP's aspirations, questions may again be raised about whether a voting system that effectively excludes millions of "third party" supporters can persist, particularly give the need for a Parliament to negotiate a beneficial exit strategy.

Given the apparent vitriol of the campaign and the sentiments the referendum campaign has unleashed, many of the (often contradictory) aspirations which have surfaced may prove impossible to assuage. As a result, it may prove difficult to simply return to the traditional Westminster two-party confrontations that have marked “politics as normal”.

4. Economic Impact Nationally

On Friday, the markets reacted dramatically as the scale of the Leave victory became increasingly apparent, Sterling fell to historic lows at unprecedented rates of depreciation (falling from 1.50 against the US$ to below 1.32) and global stock markets were also hit, with banking stocks in the UK hit badly on market opening. Early trading on Monday saw further Sterling depreciation, although the rate of fall was less pronounced easing to 1.3211 against the US dollar by midday. The US opening was 1.3202. Whilst many City analysts appear to have been wrong-footed by the referendum result, some are now forecasting that in the second half of the year Sterling US dollar rates could drift toward lows in the 120s.



The Governor of the Bank of England, whose position was itself queried during the campaign by the Leave side, stated on Friday that the Bank has contingency plans in place. This was reinforced by Monday’s pre-market opening address by Chancellor George Osborne who called for market calm, reiterating that effective contingency plans are in place and operational. However, given the scale of transactions and fund flows in the City there must be concerns as to whether the authorities have sufficient resources at their disposal should negative market strategies emerge during the week. The weekend has given global market players time to pause for thought and digest the potential implications of the leave vote.

Global central banks can be expected to take further co-ordinated action if market volatility persists through this week and Sterling comes under continued pressure. Critically, international pressures to defend the Pound could include demands that the UK tightens monetary policy should the situation persist. Similarly, the government may need to reprofile its fiscal stance if the markets make further speculative attacks, with an earlier indication of market sentiment toward UK fiscal policy due at the forthcoming gilts auction on 5th July. Any evidence of a bond strike by overseas investors could seriously impair the government's economic growth programme.

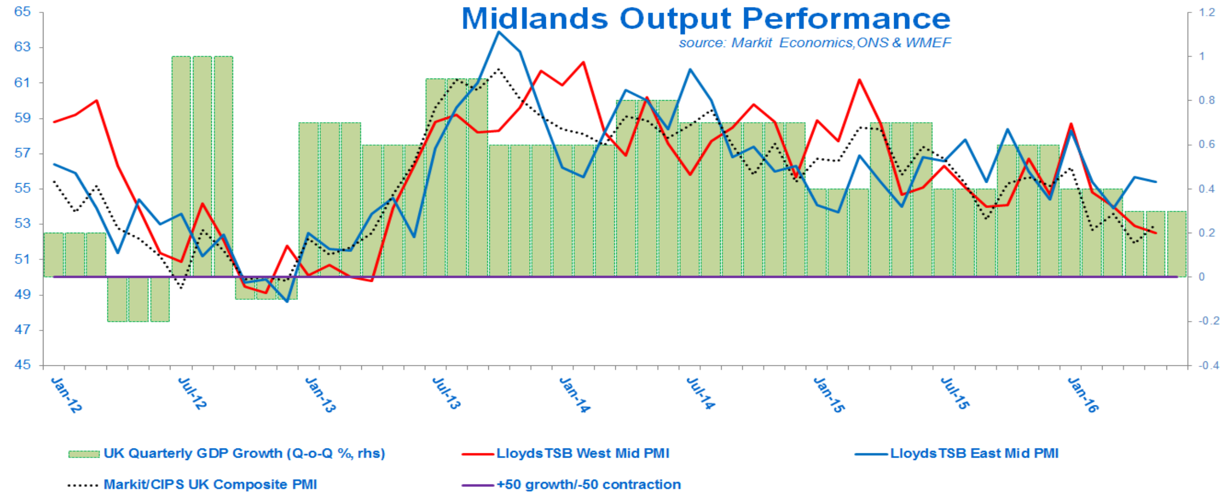
At this stage it may be premature to make predictions on the likely course of market trends. Nevertheless, it is not beyond the bounds of probability that some calm may be restored as international investors recognise the strengths of the British economy and its revived potential for robust growth. The fact that the exit process will be played out over the next two-and-a-half years offers the opportunity for a more measured assessment of the economic risks pertaining to the constituent parts of the UK. Indeed should market stability be restored, the UK economy could benefit from the depreciation of Sterling, if today's rate proves to be a new benchmark.

5. Regional Impact

In such unsettled market conditions, it is difficult to make hard forecasts as to the future direction of the Midlands economy. However, in the short term, the economic impact is likely to be dominated by two factors: the uncertainty engendered by the referendum results and the dramatic depreciation in sterling. The former will almost certainly have a negative impact on investment (including FDI) in the short term, whilst the latter is likely to give a boost to export competitiveness (but paradoxically increase the attractiveness of regional assets for FDI consideration).

In the longer term, the key factor is that it is unlikely that an EU exit agreement can be secured on such favourable terms as exist currently. Only when the exit agreement is secured, will it be possible to make a proper appraisal of the benefits and costs likely to accrue to the region. If, as some Leave campaigners have suggested, more effective access to and deeper penetration of non-EU markets can indeed be secured, a more effective business regulatory environment established and, crucially, more enhanced funding flows to the regions delivered (as a result of the assumed benefits of the redirection of official budget transfers to the EU), then more robust growth than previously forecast could theoretically be obtained. In practice, achieving this is likely to prove problematic at best.

Irrespective of the ultimate deal to be negotiated, any outcome that improves regional growth prospects would need to be predicated on a settlement that supports the regional economy, which given the preponderance of production (including manufacturing) and related services sector industries, London-centric negotiations may overlook. Furthermore, some proponents of exit have advocated an external policy orientation that could, as they themselves stated, lead to a further major contraction of the manufacturing sector.



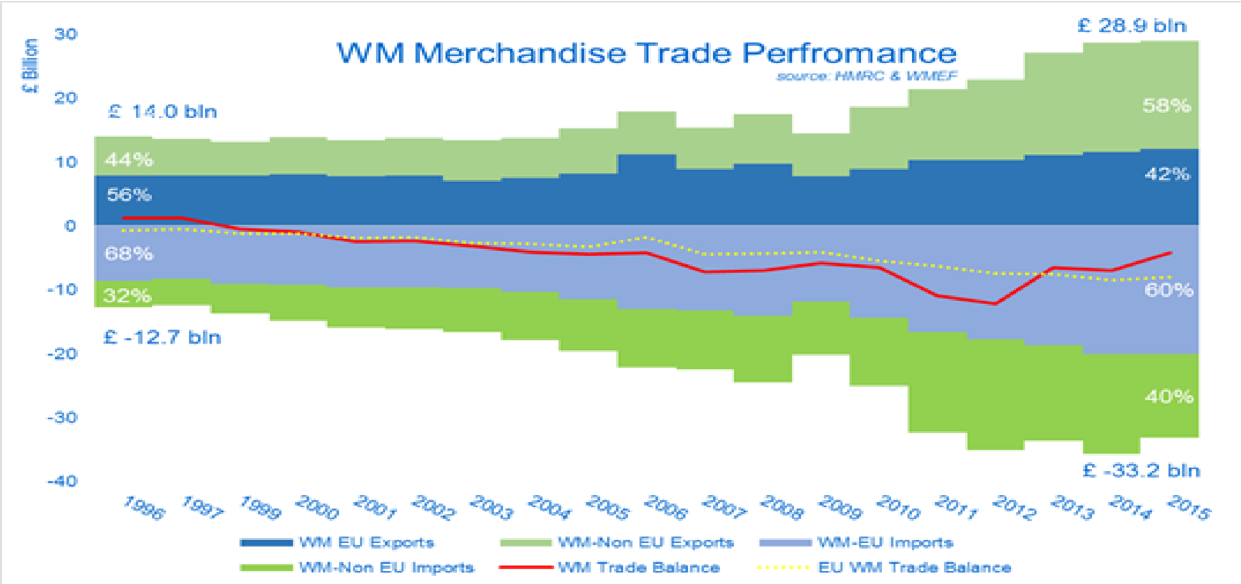
6. Policy Preferences (for discussion)

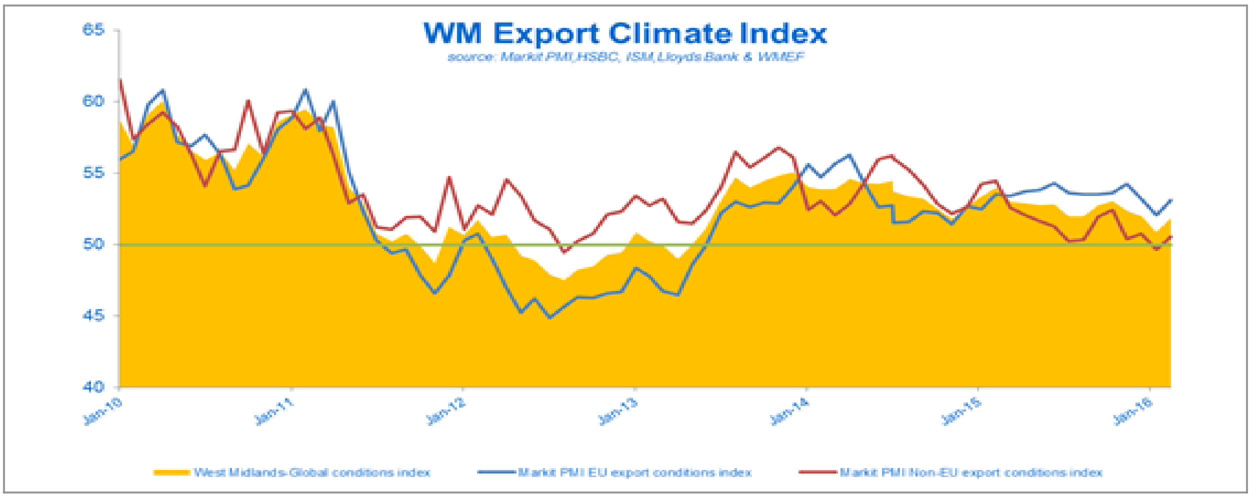
The Prime Minister has already confirmed the involvement of the devolved administrations in Wales, Scotland and Northern Ireland as well as the Greater London Authority in negotiations. As such, it is crucial that the Midlands ensures that its voice is heard. The region has a larger population than any of the aforementioned devolved nations and lies at the very heart of the UK's manufacturing sector and distribution network. The following should be urgently considered as negotiating priorities:

- Representation for the Midlands in any consultations on exit negotiations at least equal to that afforded to Greater London
- Maintenance of all funding flows into the region from EU programmes (to be replaced by domestic funding if necessary at an equivalent or greater level)
- Maintenance of education funding (including HE funding) for the region at previous levels (with EU funding to be replaced by domestic funding if necessary at an equivalent or greater level)

- The establishment of a Manufacturing Conference Board to lobby on behalf of the manufacturing sector and associated service industries
- The creation of a Manufacturing Sector Task Group to advise on the economic impact of proposed changes and give a counter-balance to City (and financial services sector) focussed economic discussions
- Ensuring continued access to EU (and global) markets for Midlands manufacturers at present privileged rates.

7. Basic Data





Midlands Basic Data					
2014 (or latest data)	Total	% of England		Total	% of England
Land Area (sq km)	28,360	21.7	Population	10,350,700	19.1
GVA (£ bln)	209,933	15.2	GVA per capita (£)	20,283	80
Economically Active	5,128,000	18.4	GVA per EA person (£)	40,939	82.9
GDHI (£ bln)	161,334	16.8	GDHI per capita (£)	15,587	87.4

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

	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 & MEF

Author(s):

Paul Forrest, Head of Research

David Hearne, Economist

Rebecca Jones, Economist

Nathan Vyse, Research Assistant

M: 07736 324 517

E: info@midlandseconomicforum.co.uk

Disclaimers

The analysis presented in this report accurately represents the personal assessment of the analyst(s) and no part of the compensation of the analyst(s) was, or will be directly or indirectly related to the inclusion of specific views in this report. Further information is available on request. The information contained, and any views expressed, herein are based on data currently available within the public domain. The contents of this Report are not a substitute for specific advice and should not be relied on as such. Accordingly, whilst every care has been taken in the preparation of this publication, no representation or warranty is made or given in respect of its contents and no responsibility is accepted for the consequences of any reliance placed on it by any person.

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.