Economic Outlook

Brexit: Uncertainty and Opportunity

August 2016

Nathaniel Lichfield & Partners
Planning. Design. Economics.

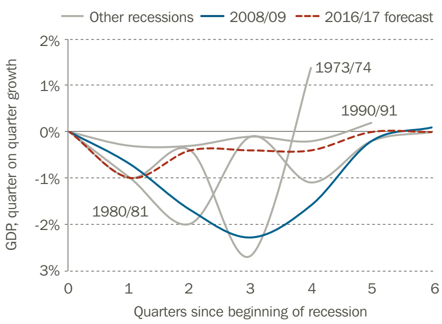
Significant political change has swept the country. How will the uncertainty resulting from the vote to leave the EU impact on local economic growth and development?

The EU referendum has affected the economy – after the result, share and currency markets fell substantially. However, the economy of 2016 does not resemble that of 2007 and, while there is uncertainty about future UK-EU negotiations it is considered less likely that the economy will face the same degree of upheaval as occurred during the financial crisis – forecasts suggest this downturn will be shallower and less pronounced (Figure 1).

As Figure 2 shows, pre-EU Referendum economic indicators were positive but not at the boom levels seen in 2007. Quarter-on-quarter growth had been relatively stable at 0.5%; business investment showed some growth; housing transactions and the retail sector grew, reflecting consumer confidence.

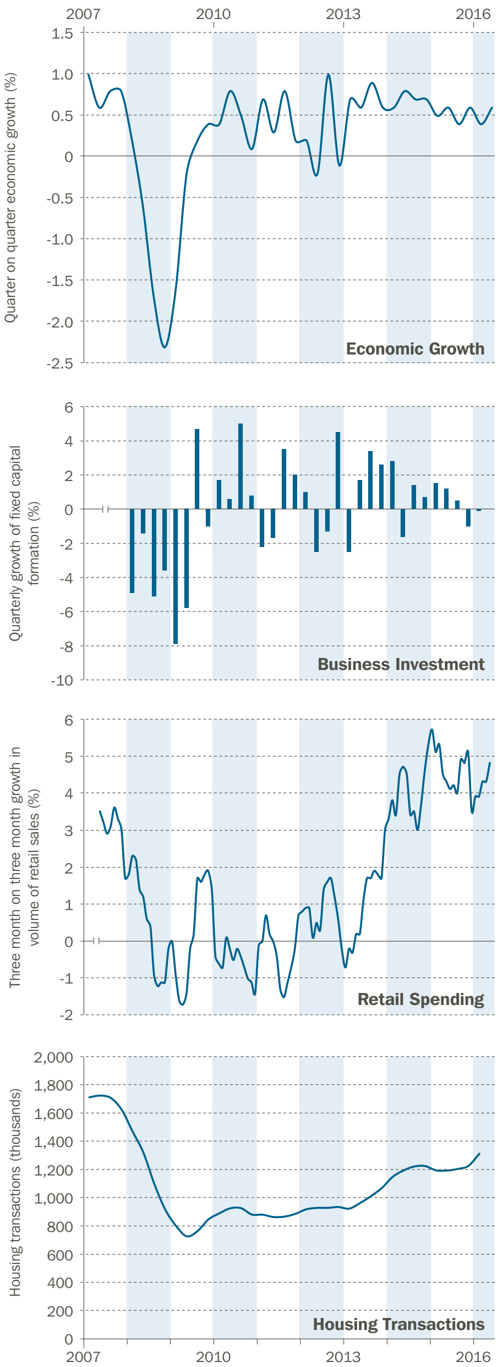
The new Chancellor, Philip Hammond, provided reassurance and highlighted a will to distance future policies from the budget surplus target sought by his predecessor, as the UK enters a 'new phase'. On the 4th August, the Bank of England provided further stimulus intervention by cutting base rates from 0.5% to 0.25% and increasing the level of quantitative easing - including buying £10bn of corporate bonds to firms 'making a material contribution to the UK economy'. This edition of Economic Outlook highlights potential impacts of Brexit. Page two looks at key considerations for the UK after leaving the EU; page three reviews LEP exposure to Brexit risks; and page four explores the regional impact of Brexit.

Figure 1 : Past and forecasted recessions



Source : HM Treasury, NLP analysis

Figure 2 : Pre-EU referendum performance



Source : ONS, NLP analysis

Headline Figures

0.6%	GDP quarterly growth for Quarter 2 of 2016
-0.1%	Growth in business capital investment in Quarter 1 of 2016
4.8%	Retail volume sales growth (3 month on 3 month a year earlier) in May 2016
1.3 million	Annual housing transactions (Q2 2015 – Q1 2016)
0.4%	UK GDP growth forecast for 2017 (Experian), compared to 2.1% forecast pre-referendum
4	Number of LEPs with highest exposure to Brexit-risks (see page 3)

Considerations for the UK in a post-EU world

As Table 1 shows, the current UK-EU agreement – membership with unique arrangements – provides the economy with four key principles: freedom of movement of people and capital; and free trade of goods and services. Now the UK has voted to leave the EU, all specific agreements within each of the principles need to be bilaterally re-agreed. While this provides uncertainty it can also provide opportunities. In order to mitigate known risks, it will be necessary to agree favourable trade deals with other countries and take advantage of a weaker pound by increasing exports. Views differ on the prospects and timescales for achieving this.

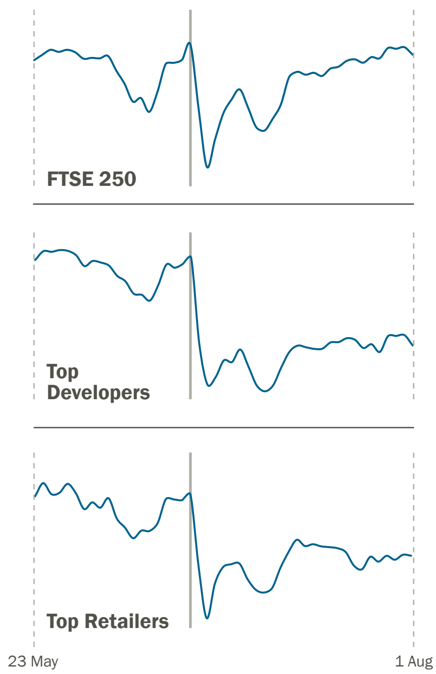
It is important to recognise that not all sectors will be affected in the same way. Looking at share values after the EU referendum result, the development and retail sectors were hit hard but the FTSE 250 – those 250 firms just below the FTSE 100 firms by market capitalisation – has recovered (Figure 3). Estimates suggest that half of FTSE 250 firms' revenues come from overseas, compared to 75-80% of FTSE 100 firms' revenue. As a consequence, FTSE 250 firms will benefit from a weaker pound but they are also a better reflection domestic performance compared to FTSE 100 firms.

Table 1 : Implications for the UK economy after leaving the EU

	UK Economy	Development Sector	Retail & High Street
Goods	Current agreements allow for free movement of exports and imports within the EU.		
Goods	Restrictions could impact negatively on imports, but future trade deals may benefit the export sectors.	Some imports, such as bricks, may become more expensive due to tariffs, subject to future trade deals.	Impact of tariffs on retail goods may have an impact on prices, if retailers decide to pass on additional costs to consumers.
People	Current agreements establish freedom of movement, work and establishment within the EU. Some occupations (medical, IT and engineering among others) face shortages already.	Current agreements are not sufficient to tackle skills shortages, currently for positions such as engineers and contaminated land specialists.	Current agreements are not sufficient to tackle skills shortages, currently for positions such as chefs.
People	Restrictions to EU migration could worsen existing skills shortages, requiring new, targeted immigration criteria and/or a step change in education and skills.	Existing skills shortages could worsen and potentially new ones could emerge in jobs currently filled by EU citizens.	Skills shortages may emerge, as EEA-born UK residents make up 14% of employees in the accommodation and food services sector and 6% in the wholesale and retail sector.
Services	Current agreements establish freedom to provide and receive services within the EU.		
Services	Restrictions could increase red tape with the EU, but new agreements could boost overall trade in services, which under current agreements is much less integrated than that of goods.		
Capital	Current agreement allow for free movement of capital and payments within the EU.		
Capital	Restrictions could impact negatively on the financial services and insurance sectors. This accentuates the need to strike favourable deals with emerging markets globally.	Negative impacts on the financial and insurance sectors may have repercussions on the development sector (e.g. availability and cost of credit).	Negative impacts on the financial and insurance sectors may have repercussions on the retail sector (e.g. availability and cost of credit).

Source : ONS, HM Government, Home Office Shortage Occupations List, NLP analysis on likely outcomes

Figure 3 : Selected share prices



Source : Bloomberg, NLP analysis

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What might Brexit mean for LEP areas?

The impact of leaving the EU is uncertain at a national and local level. Table 2 shows the forecast level of GDP growth to 2021 by Experian and three indicators that examine the impact that Brexit could have on Local Enterprise Partnership (LEP) areas. These indicators focus on labour market, EU funding and EU export sectors.

Places that are potentially most and least 'exposed' to Brexit changes are indicated as red and green, respectively. Due to the complexity of local economies, there is a high degree of variation but four LEPs initially appear most exposed – Coventry and Warwickshire, Cumbria, Humber, and North Eastern.

Table 2 : Degree of exposure to Brexit risks by Local Enterprise Partnership (LEP)

	Levels of GVA growth	Job market and EU migration	EU funding	Representation in EU export sectors
Black Country	Most exposed	Moderate	Most exposed	Least exposed
Buckinghamshire Thames Valley	Least exposed	Moderate	Least exposed	Moderate
Cheshire and Warrington	Moderate	Moderate	Most exposed	Most exposed
Coast to Capital	Least exposed	Moderate	Least exposed	Moderate
Cornwall and the Isles of Scilly	Most exposed	Least exposed	Most exposed	Least exposed
Coventry and Warwickshire	Moderate	Most exposed	Most exposed	Most exposed
Cumbria	Most exposed	Most exposed	Most exposed	Least exposed
D2N2	Moderate	Moderate	Moderate	Moderate
Dorset	Moderate	Moderate	Moderate	Least exposed
Enterprise M3	Least exposed	Moderate	Least exposed	Moderate
Gloucestershire	Moderate	Least exposed	Moderate	Moderate
Greater Birmingham and Solihull	Most exposed	Moderate	Moderate	Moderate
GCGP	Least exposed	Least exposed	Least exposed	Moderate
Greater Lincolnshire	Moderate	Most exposed	Moderate	Most exposed
Greater Manchester	Moderate	Least exposed	Most exposed	Most exposed
Heart of the South West	Moderate	Moderate	Moderate	Least exposed
Hertfordshire	Least exposed	Least exposed	Least exposed	Moderate
Humber	Most exposed	Most exposed	Moderate	Most exposed
Lancashire	Moderate	Moderate	Most exposed	Moderate
Leeds City Region	Most exposed	Least exposed	Moderate	Moderate
Leicester and Leicestershire	Moderate	Most exposed	Moderate	Moderate
Liverpool City Region	Most exposed	Moderate	Moderate	Moderate
London	Least exposed	Least exposed	Moderate	Most exposed
New Anglia	Moderate	Most exposed	Least exposed	Least exposed
North Eastern	Most exposed	Most exposed	Most exposed	Moderate
Northamptonshire	Moderate	Most exposed	Moderate	Most exposed
Oxfordshire LEP	Moderate	Moderate	Least exposed	Moderate
Sheffield City Region	Moderate	Least exposed	Moderate	Least exposed
Solent	Moderate	Most exposed	Least exposed	Least exposed
South East	Least exposed	Least exposed	Least exposed	Least exposed
South East Midlands	Least exposed	Moderate	Least exposed	Most exposed
Stoke-on-Trent and Staffordshire	Most exposed	Moderate	Moderate	Least exposed
Swindon and Wiltshire	Moderate	Most exposed	Moderate	Most exposed
Tees Valley	Most exposed	Moderate	Most exposed	Moderate
Thames Valley Berkshire	Least exposed	Most exposed	Least exposed	Moderate
The Marches	Moderate	Moderate	Most exposed	Moderate
West of England	Least exposed	Moderate	Moderate	Most exposed
Worcestershire	Moderate	Least exposed	Moderate	Least exposed
York and North Yorkshire	Most exposed	Moderate	Moderate	Moderate

Key: Least exposed ● Moderate ● Most exposed

Source : Experian Economics, ONS, BIS, NLP analysis

" Current uncertainties emphasise the need for LEPs and other local policy makers to take a proactive role in preparing for the risks - and taking advantage of the opportunities - associated with Brexit "

NLP View
August 2016

" We need a proper industrial strategy that focuses on improving productivity, rewarding hard-working people with higher wages and creating more opportunities."

Theresa May,
Prime Minister
August 2016

Methodology

GVA growth
Economic growth outlook to 2021 based on Experian forecasts, July 2016

Job Market and EU migration
Based on levels of jobs growth and EU migration, 2009-2015

EU funding
Based on levels of EU Structural Funds per capita, 2014-2020

Representation in EU export sectors
Based on levels of local employment in sectors exporting to the EU, 2014

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The post-EU referendum impacts on regional economies

In late July, medium term forecasts for GVA and jobs growth from Experian were revised to account for the economic and political uncertainty following the result of the EU referendum.

The latest forecasts expect the UK economy to grow by 0.4% in 2017, compared to the annual increase of 2.1% previously forecasted. On average, the annual GVA growth rate up to 2021 has been revised from 2.3% to 1.5%.

Similarly, the latest forecasts for employment growth were revised downwards, with 1.1 million jobs expected to be created in the UK up to 2021, compared to just over 1.3 million jobs previously forecasted.

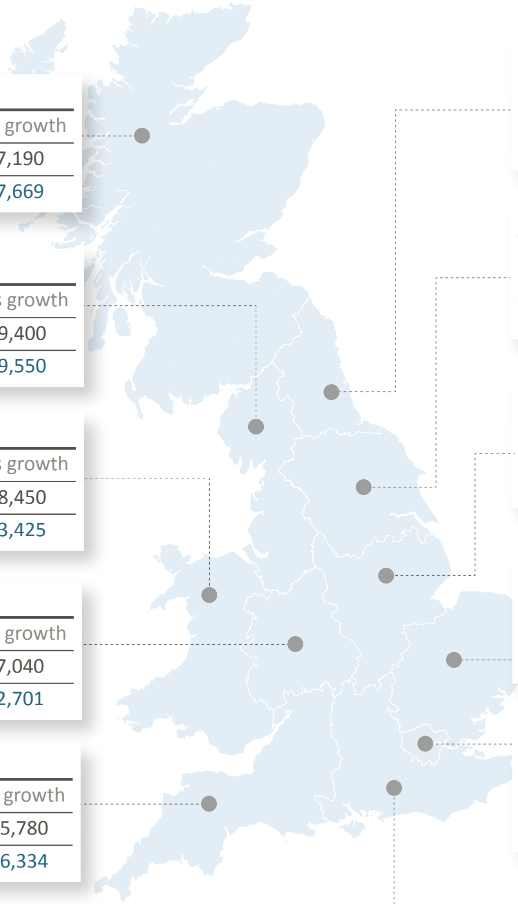
Interestingly, economic and employment growth are expected to be slower across all regions following the result of the EU referendum, but the uneven spatial trends remained unaffected by the revisions (Figure 4). No regional economy is expected to shrink on an annual basis and almost all regions are forecasted to grow each year over the next five years, albeit at a slower pace. Growth in Scotland and Wales, whose forecasts have faced the most pronounced revisions both in terms of economic and employment growth, is forecasted to pause in 2017 and pick up again from 2018.

Conversely, over the next five years unemployment rate levels are expected to increase across all regions, but showing almost opposite spatial trends compared to the economic growth forecasts. Unemployment rate is forecasted to increase in the Southern regions (from 4.1% in 2015 to 5.2% in 2021) and in London in particular (from 6.3% in 2015 to 8.5% in 2021). As a consequence, London, whose unemployment rate is structurally higher than the national average, is expected to be the region with the highest unemployment rate in the UK by 2021.

Of course, economic forecasting at a time of uncertainty is subject to inevitable caveats. It will be sometime before we can assess the accuracy of these predictions and judge the scale of economic cost and opportunity presented by the EU referendum.

Figure 4 : Economic forecasts by region, 2016-2021

Key:
Pre-EU referendum forecast
Post-EU referendum forecast



Scotland

GVA growth	Jobs growth
1.7%	47,190
0.9%	37,669

North West

GVA growth	Jobs growth
1.9%	89,400
1.1%	69,550

Wales

GVA growth	Jobs growth
1.6%	48,450
0.9%	43,425

West Midlands

GVA growth	Jobs growth
2.0%	87,040
1.2%	72,701

South West

GVA growth	Jobs growth
2.2%	135,780
1.4%	116,334

North East

GVA growth	Jobs growth
1.7%	15,320
1.0%	12,572

Yorkshire and The Humber

GVA growth	Jobs growth
1.9%	71,630
1.1%	58,502

East Midlands

GVA growth	Jobs growth
2.1%	97,990
1.4%	85,197

East

GVA growth	Jobs growth
2.3%	131,510
1.6%	108,994

London

GVA growth	Jobs growth
1.6%	48,450
0.9%	43,425

South East

GVA growth	Jobs growth
2.4%	241,140
1.6%	200,967

Source : Experian Economics, NLP analysis

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