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UK POWERHOUSE

Brexit and the Impact on British Industry

May 2019

Cebr

Welcome

to the latest edition of

UK Powerhouse

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This is the third in our series of special studies examining the impact of Brexit on the UK economy.

I must admit that, last year, when we commissioned the Centre for Economics & Business Research (Cebr) to write these reports, I was expecting that we would no longer be in the EU by now.

It's now three years since the referendum, and sadly we're still very unclear about when exactly we will leave the EU and what the terms will be.

We now have another delay and, although the majority of businesses would prefer to avoid a no-deal situation, I can certainly sympathise with organisations up and down the country which are desperate for certainty in order to move forward and start investing for the long-term again.

This UK Powerhouse report looks at city growth by both gross value added (GVA) and employment – not just for the last three months of 2018, but also in the final quarter of 2020. This takes us to 12 months after what is now the expected departure date.

There's also a detailed review of how Brexit is likely to affect the growth of our key industries. This review starts on page 24 and analyses manufacturing, hospitality, retail, construction, and financial and business services.

I hope that you find this report interesting. If there's anything that you would like to speak to us in relation to Brexit, please don't hesitate to get in touch.

Key Findings

The hospitality sector will be affected by more limited access to workers from the EU, who currently make up 13 % of employees in the sector.

The automotive industry faces significant problems, with 51 % of all UK-built cars being bought by customers in the EU in 2018.

Tax receipts from the banking sector amounted to £28.5bn in the 2017-18 financial year, some of which could be lost as businesses relocate their taxable assets.

The construction industry could see a slight acceleration of annual growth in 2020, to 1.7 %.

Brexit presents opportunities in construction – removing regulation red tape, currently mandated by the EU, could make construction a more straightforward process.

Savings in cash and deposits by households increased by £5.3bn in February 2019 as individuals showed unwillingness to spend money that could be saved.

Executive summary

Irwin Mitchell's
Powerhouse Tracker

Official economic data sources for the UK's cities are often dated and fail to provide a reliable snapshot of the UK's localised economies – the last set of regional economic accounts corresponds to the economy in 2017. To more accurately estimate current economic activity, Cebr has utilised a range of more timely indicators to create a 'nowcast' of GVA and employment for a range of key cities across the UK. The latest outputs of this give us a picture of how the regional economies of the UK performed in Q4 2019. In this City Tracker report, we also develop a city forecast to Q4 2020 and provide forecasts and commentary on how Brexit is affecting different industries in the UK.

Key Facts

- Growth in the UK economy slowed to 0.2 % quarter-on-quarter in the final quarter of 2018, down from 0.6 %
- The total number of people in employment rose to 32.6 million in Q4 – 444,000 more than a year earlier
- The top Powerhouse city in the UK in terms of GVA growth rate for Q4 2018 is Reading, with an estimated 2.7 % annual growth. By Q4 2020, we forecast that its growth will slow to 2.0 %
- Exeter recorded the fastest rate of employment growth out of the Powerhouse cities in Q4 2018, and the city is expected to hold that position in Q4 2020 as well
- Out of the five sectors studied – manufacturing, retail, construction, financial and business services, and hospitality – the hospitality sector has the highest share of non-UK EU workers who could be affected by Brexit.

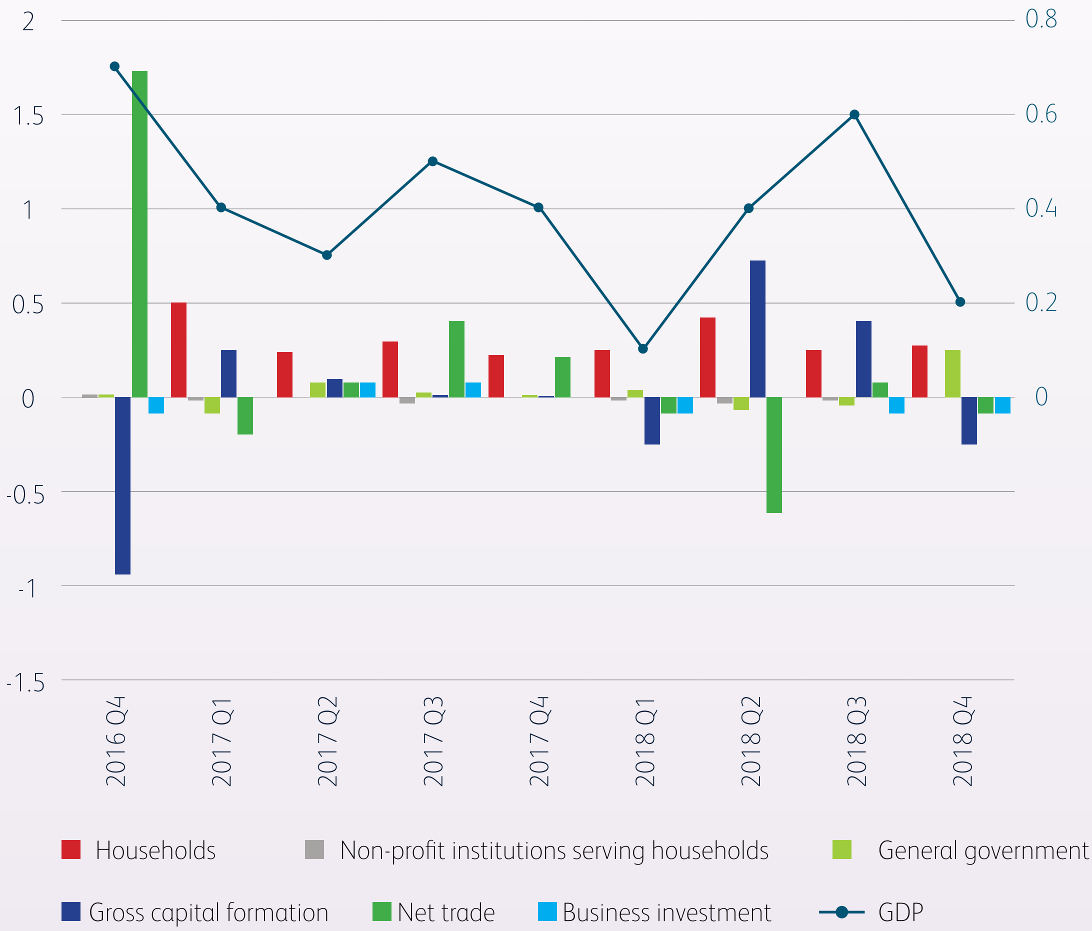
UK economy:
2018 suffered slowest growth since 2012

In the final quarter of 2018, growth in the UK economy slowed to 0.2 % quarter-on-quarter, down from 0.6 % in the third quarter. This marks the slowest quarterly growth rate since Q1 2018, when the economy nearly ground to a halt due to the extreme weather brought about by the 'Beast from the East.' Over 2018 as a whole, the economy expanded by 1.4 %, compared with 1.8 % in 2017. UK gross domestic product (GDP) last increased by just 1.4 % in 2012 and has not been weaker since 2009.

In Q4, a widespread slowdown in the manufacturing sector weighed on growth. This was in part due to car makers' problems adjusting to regulatory changes, as well as the uncertainty surrounding the future of diesel engines. Since output in mining and the energy industry also decreased, the production sector contracted by 0.8 % over the fourth quarter, while the construction sector shrank by 0.5 %. Meanwhile, the services sector, by far the largest part of the UK economy, saw growth of 0.5 % in Q4. This brings annual growth in services to 1.7 %, the weakest it has been since 2011.

In terms of the expenditure approach to GDP, spending by households and the government provided upward pressure, while gross capital formation, net trade and business investment all made downward contributions to the headline growth rate.

Figure 1 - GDP percentage growth (RHS); UK expenditure components percentage contribution to GDP growth (LHS), quarter-on-quarter



Source: Office for National Statistics, Cebr analysis

UK labour market data showed that the unemployment rate stood at 4 % in the three months to December 2018, maintaining its record low since February 1975, and the employment rate was stable at 75.8 %. The number of people in employment rose to 32.6 million – 444,000 more than a year earlier. The limited spare capacity in the labour market is placing upwards pressure on wage growth, with average wages (including bonuses) growing at 3.5 % compared to a year ago in Q4 2018.

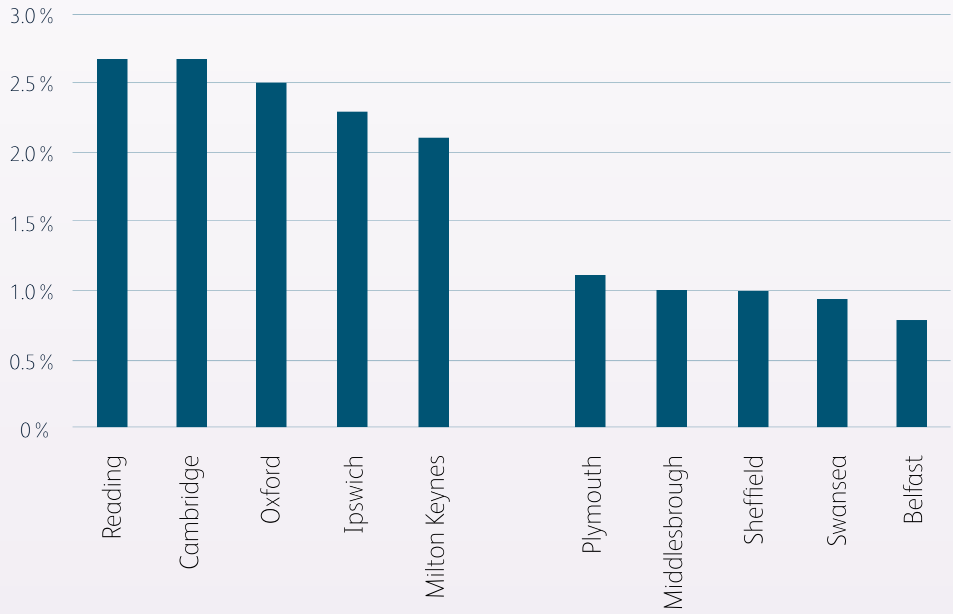
UK Cities in Q4 2018
Powerhouse Table

GVA

League table ranking		GVA Q4 2018, £millions (Annualised, constant 2013 prices)	Growth (YoY)
1	**Reading**	**6,400**	**2.7%**
2	**Cambridge**	**8,900**	**2.7%**
3	**Oxford**	**8,400**	**2.5%**
4	**Ipswich**	**4,400**	**2.3%**
5	**Milton Keynes**	**11,400**	**2.1%**
6	**Norwich**	**2,600**	**2.1%**
7	**Outer London**	**122,400**	**2.1%**
8	**London**	**389,600**	**1.9%**
9	**Portsmouth**	**5,300**	**1.9%**
10	**Peterborough**	**5,300**	**1.9%**
11	Inner London	267,200	1.9%
12	Brighton	7,200	1.8%
13	Aberdeen	12,200	1.8%
14	Manchester	17,800	1.7%
15	Exeter	4,700	1.7%
16	Southampton	6,000	1.7%
17	Nottingham	8,900	1.6%
18	Rotherham	4,400	1.6%
19	Greater Manchester	60,400	1.6%
20	Coventry	8,100	1.6%

21	Birmingham	25,900	1.6 %
22	Sunderland	5,700	1.6 %
23	Bristol	13,500	1.6 %
24	Bournemouth	4,600	1.6 %
25	Glasgow	17,700	1.6 %
26	Hull	5,100	1.5 %
27	Leeds	21,500	1.5 %
28	Wakefield	6,800	1.5 %
29	Newcastle	9,400	1.5 %
30	Derby	6,600	1.5 %
31	Stoke-on-Trent	4,900	1.4 %
32	Doncaster	5,100	1.4 %
33	Stockport	6,500	1.4 %
34	Leicester	7,100	1.4 %
35	Liverpool	10,500	1.3 %
36	Edinburgh	21,300	1.3 %
37	Swindon	6,600	1.3 %
38	York	4,800	1.2 %
39	Bradford	9,300	1.2 %
40	Wolverhampton	4,500	1.2 %
41	Cardiff	10,100	1.2 %
42	Plymouth	5,000	1.1 %
43	Middlesbrough	3,200	1.0 %
44	Sheffield	11,300	1.0 %
45	Swansea	4,400	0.9 %
46	Belfast	15,300	0.7 %

Figure 2 - Top and bottom five cities by annual GVA growth, Q3 2018



***Source**: Office for National Statistics, Cebr analysis*

The top Powerhouse city in the UK in terms of GVA growth rate for Q4 2018 is Reading, with an estimated 2.7 % annual growth. By Q4 2020, we forecast that growth will slow to 2 %. Reading's success is associated with its close location to London and the network of other urban areas in the South East. By Q4 2020, it's likely that Crossrail will have further improved its connection to London.

This doesn't stop Milton Keynes overtaking it to become the fastest growing city by the end of 2020. Part of the reason these cities are thriving is their sector makeup. Professional and scientific activities, as well as information and communication, are forecast to grow well in the coming years, and are significant sectors in the top Powerhouse cities.

London stands inside the top ten cities in terms of GVA growth in Q4 2018, driven by outer London boroughs.

As sectors focussed in inner London, such as banking and insurance, are affected by Brexit, outer London is forecast to grow at a comparatively faster rate. Brexit has considerably affected house prices in London, with prices in the capital falling by 3.8 % over the year to February 2019. This has driven a slowdown in England, and an annual fall of 2.2 % was noted in January 2019. There's uncertainty over the future of the capital, as potential buyers are unwilling to invest over worries prices could fall further, limiting demand.

Sunderland performed well compared to other cities in the North East in Q4 2018. The £19m Beacon of Light sports centre opened in September 2018, providing a boost to the economy through increased employment and local spending. By 2020, Newcastle is set to overtake it in terms of GVA growth rate. The North East local economic partnership is supporting the economies of both cities, with drives to expand four key strategic industries in the area: digital, advanced manufacturing, health and life sciences, and energy.

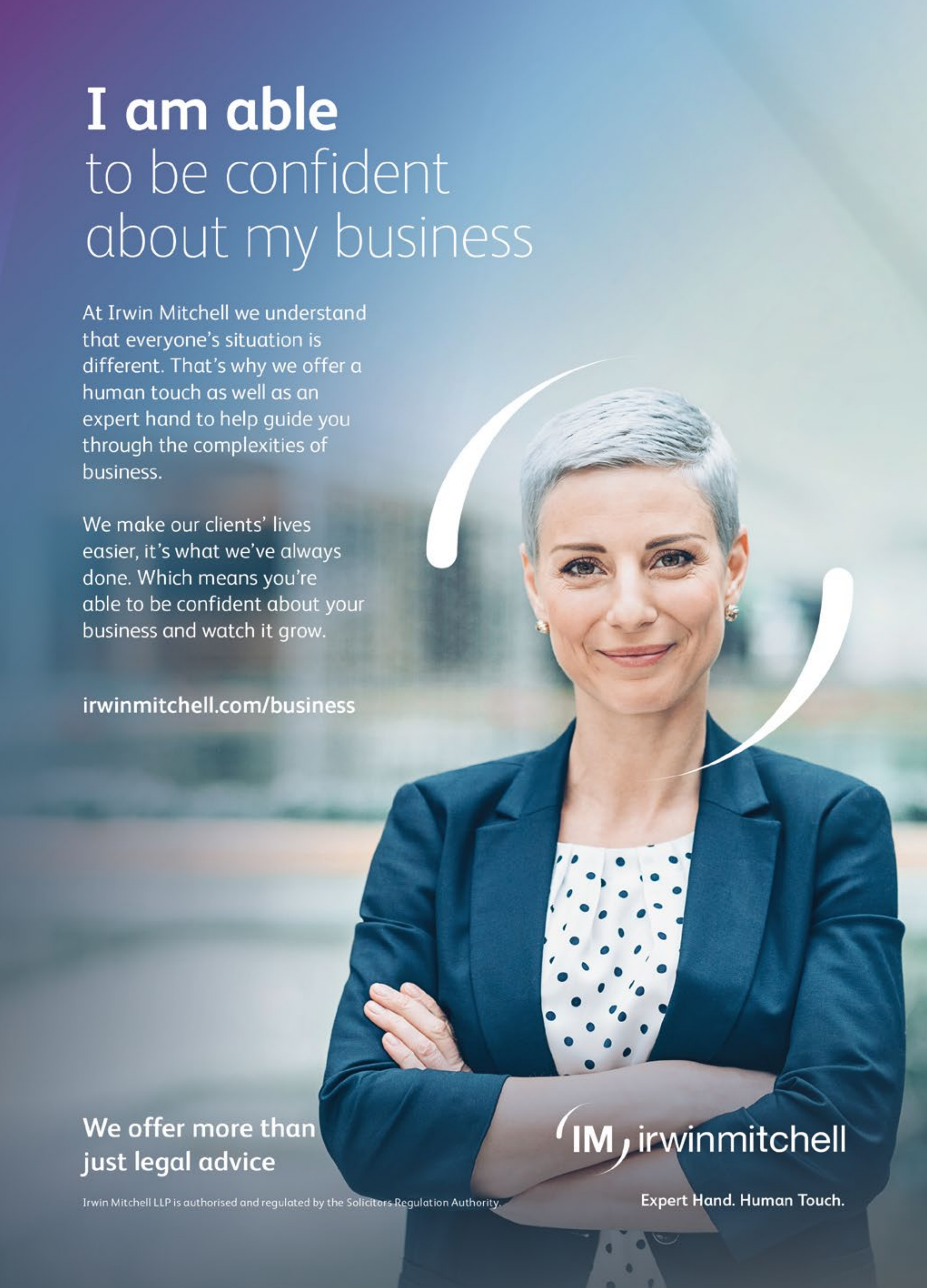
Cardiff is set to grow at 1 % by Q4 2020. This is higher than in Swansea, where year-on-year growth of 0.9 % is predicted, but it is still slower than the 1.2 % annual growth estimated for Q4 2018. The city benefits from a large university, with 75,000 students in the city region, and 43,000 just in Cardiff.[1] Students increase spending at businesses in the city, while the university also helps drive innovation in knowledge intensive industries in the region. The city has many high-growth businesses, such as MyPinPad, a world-leading innovator in payments software authentication solutions. Price comparison website confused.com, is also based in Cardiff and has been growing at a fast pace, with its parent company Admiral recording an increase in pre-tax profits of 18 % in 2018.

GVA in Plymouth was estimated to have grown at an annual rate of 1.1 % in Q4 2018, making it one of the slowest growing Powerhouse cities. The commercial and ferry port in the city is a significant source of economic activity and employment but Brexit is creating considerable uncertainty surrounding the future of UK trade with the rest of the world. This will be affecting sentiment at the port. As well as this, the decline of bricks-and-mortar retail has resulted in many large retailers entering administration, or closing down stores, in recent months. This has affected economic output in shopping centres in and around the city.

Sheffield also recorded GVA growth in the bottom five Powerhouse cities in Q4 2018. The city has relatively poor transport infrastructure, with the nearest airport situated 18 miles away in Doncaster. Capacity on the motorway network and junctions with the local network have exceeded their design capacity, leading to Highways England raising objections. For rail, trains arriving and departing from Sheffield station in the morning peak period were over capacity by 1.6 % in 2015 and the station is ranked fifth worst in terms of overcrowding, when compared to other major cities.[2] Therefore, in order to encourage a pickup in GVA growth in the city, local government should focus on improving the transport network.

[1] Source: http://www.investincardiff.com/

[2] Source: Sheffield city region transport strategy 2018 - 2040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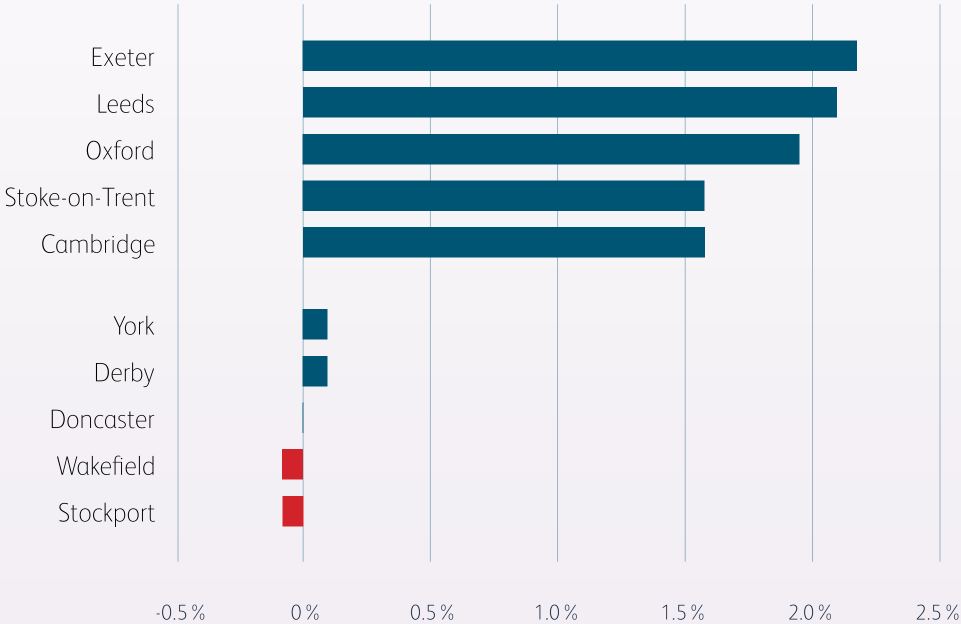
UK Cities in Q4 2018
Powerhouse Table

Employment

League table ranking		Employment Level, Q4 2018	Growth (YoY)
1	**Exeter**	**115,100**	**2.2%**
2	**Leeds**	**468,800**	**2.1%**
3	**Oxford**	**138,900**	**1.9%**
4	**Stoke-on-Trent**	**114,500**	**1.6%**
5	**Cambridge**	**136,900**	**1.6%**
6	**Manchester**	**463,100**	**1.6%**
7	**Birmingham**	**583,200**	**1.6%**
8	**Outer London**	**1,836,600**	**1.5%**
9	**Bournemouth**	**95,900**	**1.5%**
10	**Southampton**	**163,900**	**1.5%**
11	Belfast	135,500	1.4%
12	London	5,171,200	1.4%
13	Reading	127,100	1.4%
14	Liverpool	309,000	1.4%
15	Newcastle	221,600	1.4%
16	Sheffield	294,700	1.4%
17	Inner London	3,334,500	1.3%
18	Brighton	160,500	1.3%
19	Glasgow	434,500	1.3%
20	Portsmouth	128,300	1.3%

21	Greater Manchester	1,281,900	1.1 %
22	Swindon	121,400	1.1 %
23	Peterborough	115,200	1.1 %
24	Rotherham	105,900	1.1 %
25	Middlesbrough	79,700	1.0 %
26	Milton Keynes	160,200	1.0 %
27	Bradford	222,100	1.0 %
28	Cardiff	225,200	0.9 %
29	Hull	149,200	0.9 %
30	Leicester	218,800	0.9 %
31	Plymouth	149,800	0.8 %
32	Bristol	342,500	0.8 %
33	Nottingham	219,000	0.8 %
34	Edinburgh	355,500	0.8 %
35	Coventry	190,200	0.7 %
36	Aberdeen	179,800	0.7 %
37	Norwich	134,900	0.7 %
38	Sunderland	133,800	0.7 %
39	Swansea	115,200	0.5 %
40	Ipswich	79,300	0.5 %
41	Wolverhampton	117,200	0.1 %
42	York	109,700	0.1 %
43	Derby	136,900	0.1 %
44	Doncaster	125,100	0.0 %
45	Wakefield	143,100	-0.1 %
46	Stockport	116,300	-0.1 %

Figure 3 - Five fastest and slowest expanding cities by year-on-year employment growth in Q4 2018



Source: Office for National Statistics, Cebr analysis

Exeter recorded the fastest rate of employment growth out of the Powerhouse cities in Q4 2018, and the city is expected to hold that position in Q4 2020 as well. The gig economy and increased flexibility in working hours is responsible for a significant proportion of the job growth in recent quarters, as businesses are more willing to hire workers when they know it would be relatively easy to cut down their hours that in an economic downturn. In Exeter, a significant number of students work in the gig economy for companies, such as Deliveroo, adding to employment in the city.

Manchester is set to be placed within the top ten fastest growing cities in the UK for employment growth in both Q4 2018 and Q4 2020. The Northern Powerhouse city is home to several high-growth businesses, which are employing more and more people in the city.

Amazon has confirmed it will open a major new office in the city in 2019, creating 600 new technology and research jobs, while TickX, a Manchester-based ticket price comparison company, recently raised £3 million in funding. Highlighting the attractiveness of the city to investors further, Manchester ranked within the top ten major cities in the world for foreign direct investment (FDI) strategy (6th place) and also connectivity (7th place) in the Financial Times' fDintelligence Global Cities of the Future 2018/19 report.

Liverpool is estimated to have had the second fastest employment growth in the North West in Q4 2018. The recent successes of Liverpool FC will be driving consumer spending and employment, as fans celebrate in pubs and bars. In addition, the city has been the centre of regeneration and has seen over £4.5 billion of investment in recent years,[3] transforming the leisure, retail and commercial sectors to create employment and support the local economy.

Despite being forecast to have the fastest GVA growth in the South East by Q4 2020, Milton Keynes is expected to have the slowest employment growth out of the six cities in the South East on the Powerhouse table. This implies that there will be an improvement in productivity for the city, as each worker is projected to produce more in terms of GVA for each hour of work. Productivity growth can come from technological advancements, and given that Milton Keynes has a sizeable tech sector, it's likely to be a driver of new technology creation over the coming years.

[3] Source: https://www.certainvest.co.uk/choose-invest-liverpool/

UK Cities in Q4 2020
Powerhouse Table

GVA

League table ranking		GVA Q4 2020, £millions (Annualised, constant 2013 prices)	Growth (YoY)
1	**Milton Keynes**	**12,000**	**2.1%**
2	**Reading**	**6,700**	**2.0%**
3	**Oxford**	**8,800**	**1.9%**
4	**Cambridge**	**9,300**	**1.8%**
5	**Brighton**	**7,500**	**1.8%**
6	**Southampton**	**6,300**	**1.8%**
7	**Ipswich**	**4,600**	**1.7%**
8	**Norwich**	**2,700**	**1.7%**
9	**Inner London**	**275,100**	**1.7%**
10	**London**	**401,500**	**1.6%**
11	Bournemouth	4,800	1.6%
12	Outer London	126,400	1.6%
13	Peterborough	5,500	1.5%
14	York	4,900	1.5%
15	Exeter	4,800	1.5%
16	Portsmouth	5,500	1.5%
17	Manchester	18,300	1.4%
18	Glasgow	18,300	1.4%
19	Stockport	6,700	1.4%
20	Doncaster	5,200	1.4%

21	Nottingham	9,200	1.3 %
22	Birmingham	26,600	1.3 %
23	Wakefield	7,000	1.3 %
24	Edinburgh	21,800	1.3 %
25	Bristol	13,800	1.3 %
26	Rotherham	4,600	1.3 %
27	Swindon	6,700	1.2 %
28	Greater Manchester	61,900	1.2 %
29	Liverpool	10,800	1.2 %
30	Leeds	22,000	1.1 %
31	Newcastle	9,600	1.1 %
32	Coventry	8,300	1.1 %
33	Sheffield	11,600	1.1 %
34	Aberdeen	12,600	1.1 %
35	Leicester	7,300	1.1 %
36	Stoke-on-Trent	5,100	1.1 %
37	Cardiff	10,300	1.0 %
38	Swansea	4,400	0.9 %
39	Plymouth	5,000	0.9 %
40	Belfast	15,600	0.9 %
41	Bradford	9,500	0.9 %
42	Sunderland	5,800	0.9 %
43	Wolverhampton	4,600	0.8 %
44	Hull	5,200	0.8 %
45	Middlesbrough	3,200	0.8 %
46	Derby	6,700	0.6 %

UK Cities in Q4 2020
Powerhouse Table

Employment

League table ranking		Employment Level, Q4 2020	Growth (YoY)
1	**Exeter**	**120,300**	**2.3%**
2	**Leeds**	**487,800**	**2.0%**
3	**Oxford**	**143,700**	**1.7%**
4	**Stoke-on-Trent**	**118,300**	**1.7%**
5	**Outer London**	**1,895,300**	**1.6%**
6	**Birmingham**	**601,700**	**1.6%**
7	**Manchester**	**477,300**	**1.5%**
8	**Southampton**	**169,000**	**1.5%**
9	**Cambridge**	**141,000**	**1.5%**
10	**London**	**5,316,400**	**1.4%**
11	Liverpool	317,500	1.4%
12	Sheffield	302,700	1.3%
13	Newcastle	227,600	1.3%
14	Inner London	3,421,100	1.3%
15	Brighton	164,600	1.3%
16	Bournemouth	98,400	1.3%
17	Glasgow	445,500	1.3%
18	Portsmouth	131,500	1.2%
19	Peterborough	117,900	1.2%
20	Reading	130,300	1.2%

21	Swindon	124,200	1.1%
22	Rotherham	108,200	1.1%
23	Middlesbrough	81,400	1.1%
24	Greater Manchester	1,309,400	1.1%
25	Milton Keynes	163,900	1.0%
26	Bradford	226,500	1.0%
27	Plymouth	152,700	0.9%
28	Hull	151,900	0.9%
29	Nottingham	222,700	0.9%
30	Cardiff	229,300	0.9%
31	Bristol	348,400	0.9%
32	Leicester	222,500	0.8%
33	Edinburgh	361,000	0.8%
34	Coventry	192,800	0.7%
35	Swansea	116,500	0.6%
36	Aberdeen	182,000	0.5%
37	Ipswich	80,100	0.5%
38	Norwich	136,300	0.5%
39	Sunderland	135,100	0.5%
40	Derby	138,000	0.4%
41	Wolverhampton	117,400	0.1%
42	Doncaster	125,200	0.0%
43	Belfast	135,000	-0.2%
44	Wakefield	142,700	-0.2%
45	Stockport	115,700	-0.2%
46	York	107,900	-0.8%

Brexit and British industries

If Brexit had gone according to the Prime Minister's plan, the UK would have exited from the EU and have entered a transition period, with more negotiations over the specifics of the final agreement. The three-year anniversary of the Brexit referendum is approaching quickly and the UK is still part of the EU, most likely prolonging the period of uncertainty to the end of October. This will have a negative impact on businesses across industries.

We consider how Brexit is affecting five key British industries:

Manufacturing

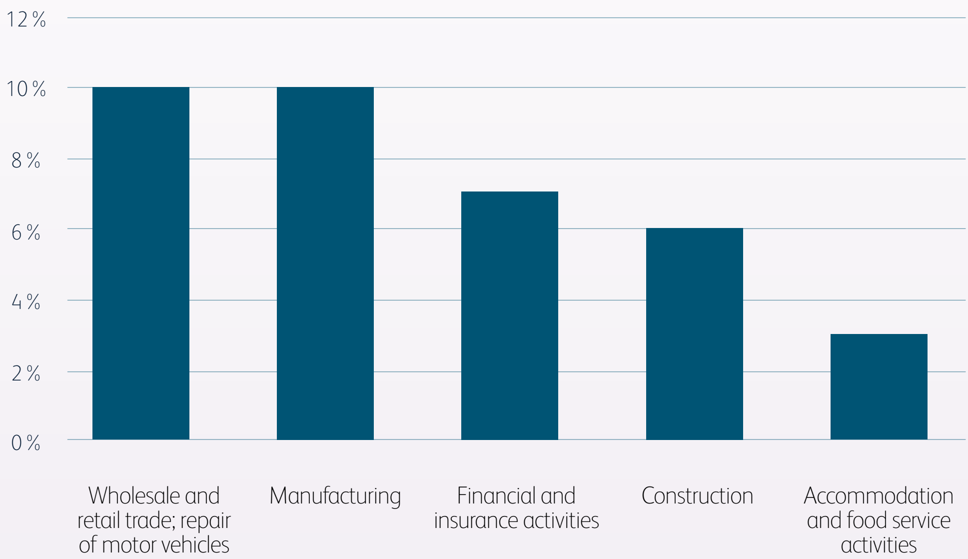
Retail

Construction

Financial and business services

Hospitality

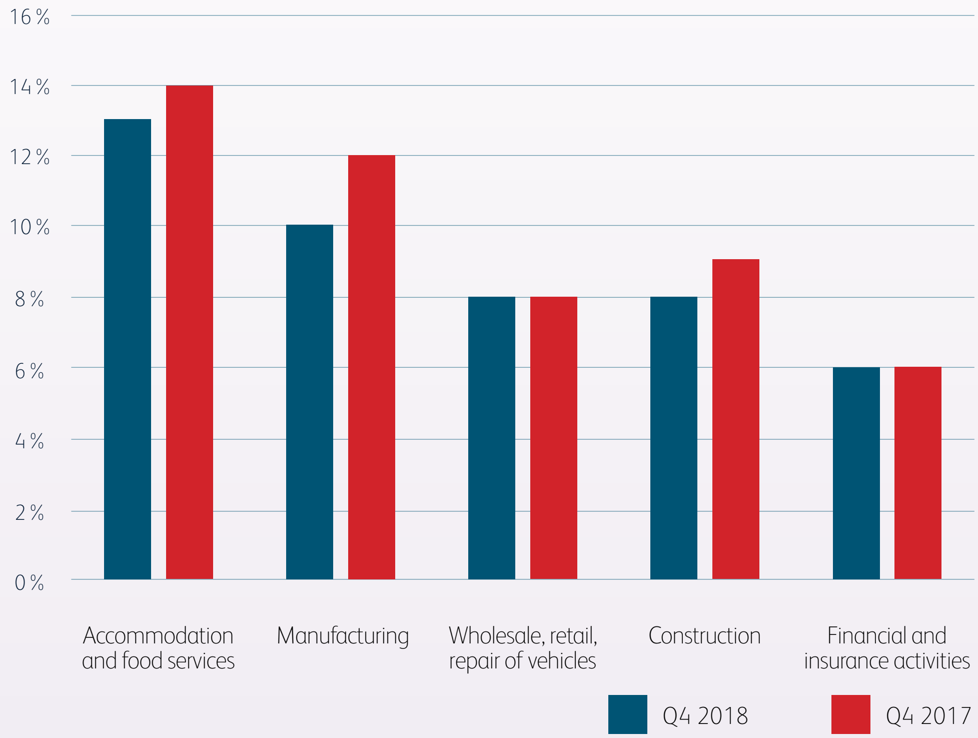
Figure 4 - Share of total GVA by industry



Source: ONS, Cebr analysis

As shown in Figure 4, the retail sector (also including wholesale and repair of motor vehicles) makes up the biggest share of the UK economy out of the five sectors analysed, followed by manufacturing, and financial and insurance services.

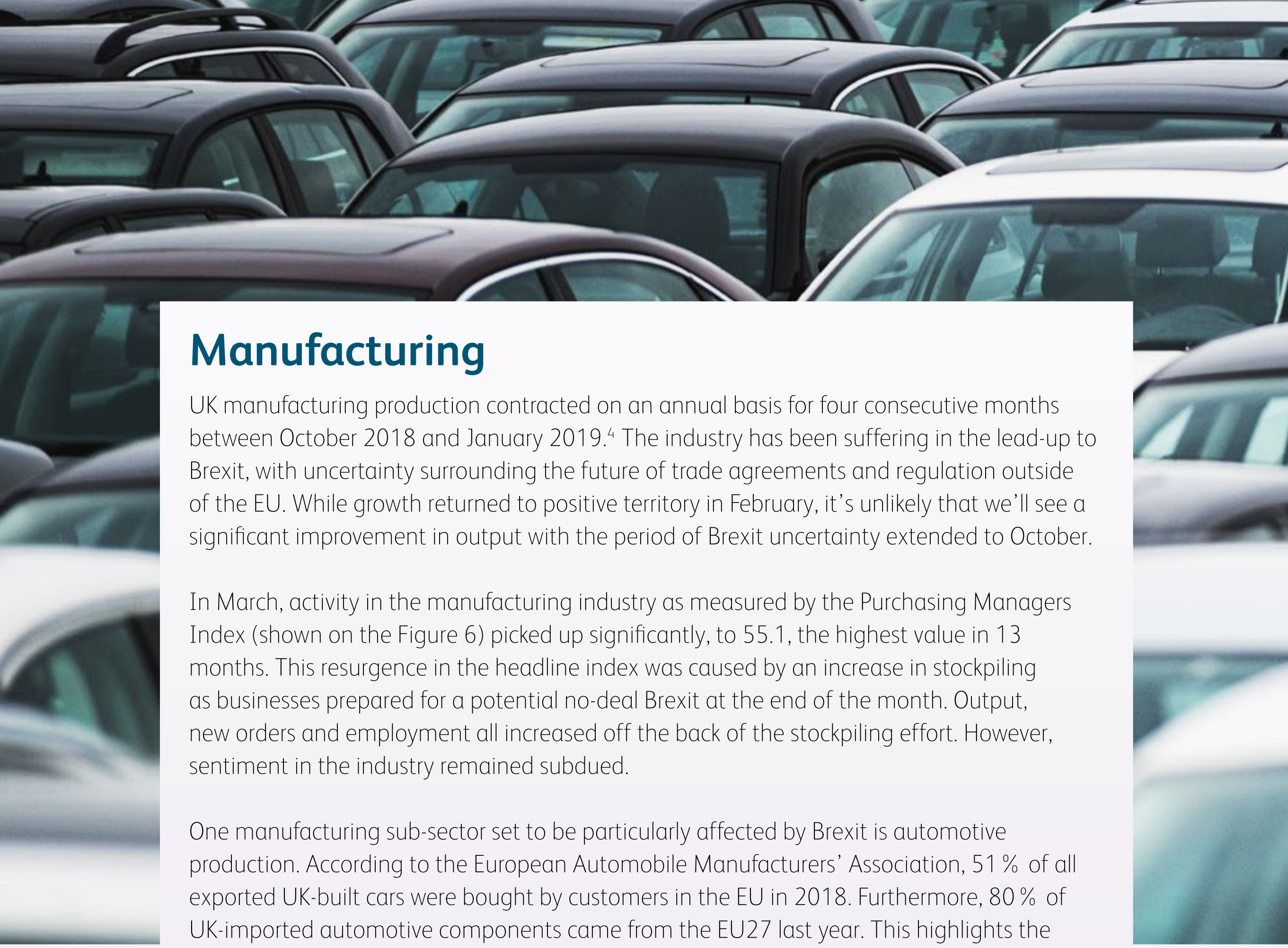
Figure 5 - Share of workers of non-UK EU nationality



Source: UK data service, Cebr analysis

Reduced access to labour from other member nations is one major way that leaving the EU will affect industries. This is most pertinent in the accommodation and food services sector. In Q4 2018, 13 % of workers in this sector were of non-UK EU nationality, down from 14 % in Q4 2017. At the other end of the spectrum, the finance and insurance sector, with 6 % in Q4 2018, has relatively fewer non-UK EU workers – this was up slightly from 5.6 % in Q4 2017.

When the UK leaves the EU, it's likely that sectors, such as the hospitality sector, which currently use EU nationals as a considerable source of labour will have to look elsewhere to fill at least some of their vacancies. This could come from unemployed or economically inactive people in the UK, or nationals from the rest of the world. In order to attract these workers, employers may have to make themselves more competitive in the labour market, by offering higher wages or other benefits, such as more annual leave, for example.



Manufacturing

UK manufacturing production contracted on an annual basis for four consecutive months between October 2018 and January 2019.[4] The industry has been suffering in the lead-up to Brexit, with uncertainty surrounding the future of trade agreements and regulation outside of the EU. While growth returned to positive territory in February, it's unlikely that we'll see a significant improvement in output with the period of Brexit uncertainty extended to October.

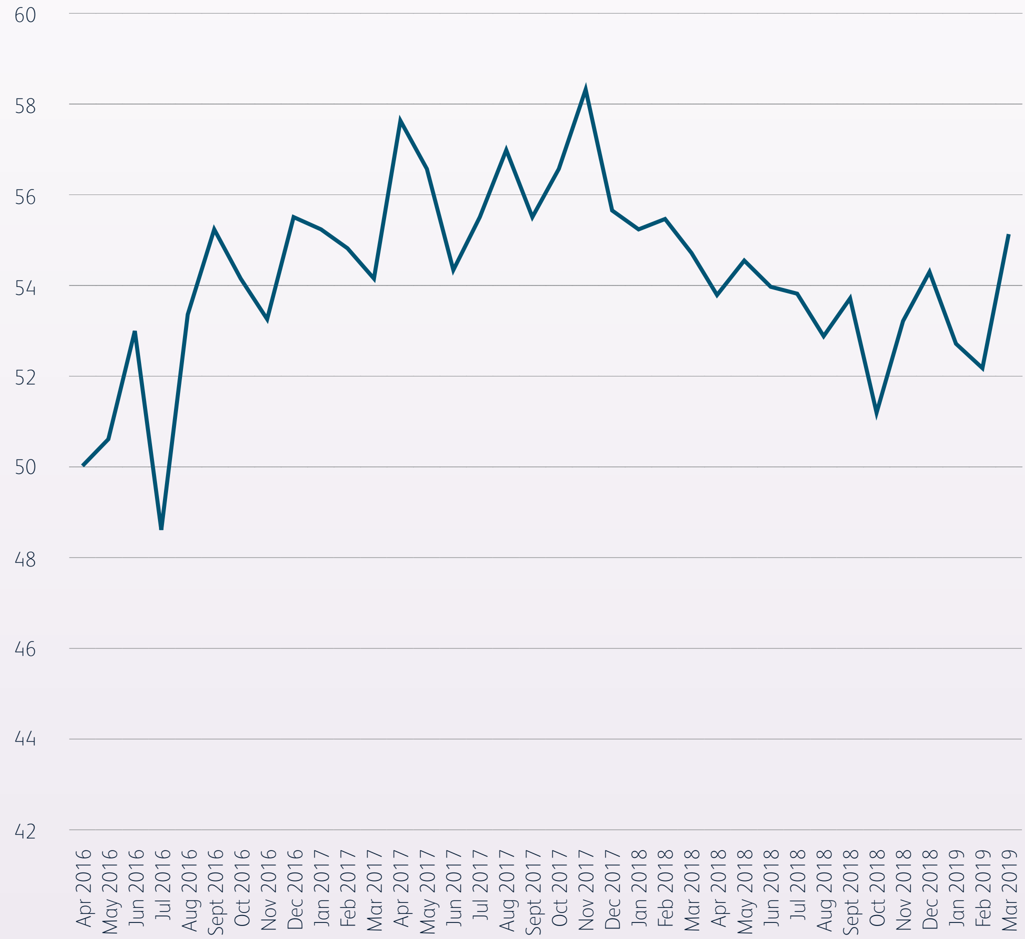
In March, activity in the manufacturing industry as measured by the Purchasing Managers Index (shown on the Figure 6) picked up significantly, to 55.1, the highest value in 13 months. This resurgence in the headline index was caused by an increase in stockpiling as businesses prepared for a potential no-deal Brexit at the end of the month. Output, new orders and employment all increased off the back of the stockpiling effort. However, sentiment in the industry remained subdued.

One manufacturing sub-sector set to be particularly affected by Brexit is automotive production. According to the European Automobile Manufacturers' Association, 51 % of all exported UK-built cars were bought by customers in the EU in 2018. Furthermore, 80 % of UK-imported automotive components came from the EU27 last year. This highlights the extent to which the UK is integrated in supply chains with the rest of the EU, which will be affected by changing trade policy post-Brexit.

Overall, Cebr expects to see an annual contraction in manufacturing sector output over the course of 2019. As a significant proportion of manufacturing goods are exported, trade relationships are important to the industry. Not only is UK trade with other countries affected by Brexit, but also by possible protectionism between the EU and US while we remain in the EU. The US has proposed targeting a list of $11bn (£8.3bn) worth of EU products for tariffs, ranging from large aircraft to dairy products and wine.

[4] Source: Office for National Statistics, Index of Production

Figure 6 - UK Manufacturing PMI



Source: IHS Markit, Cebr analysis

Retail

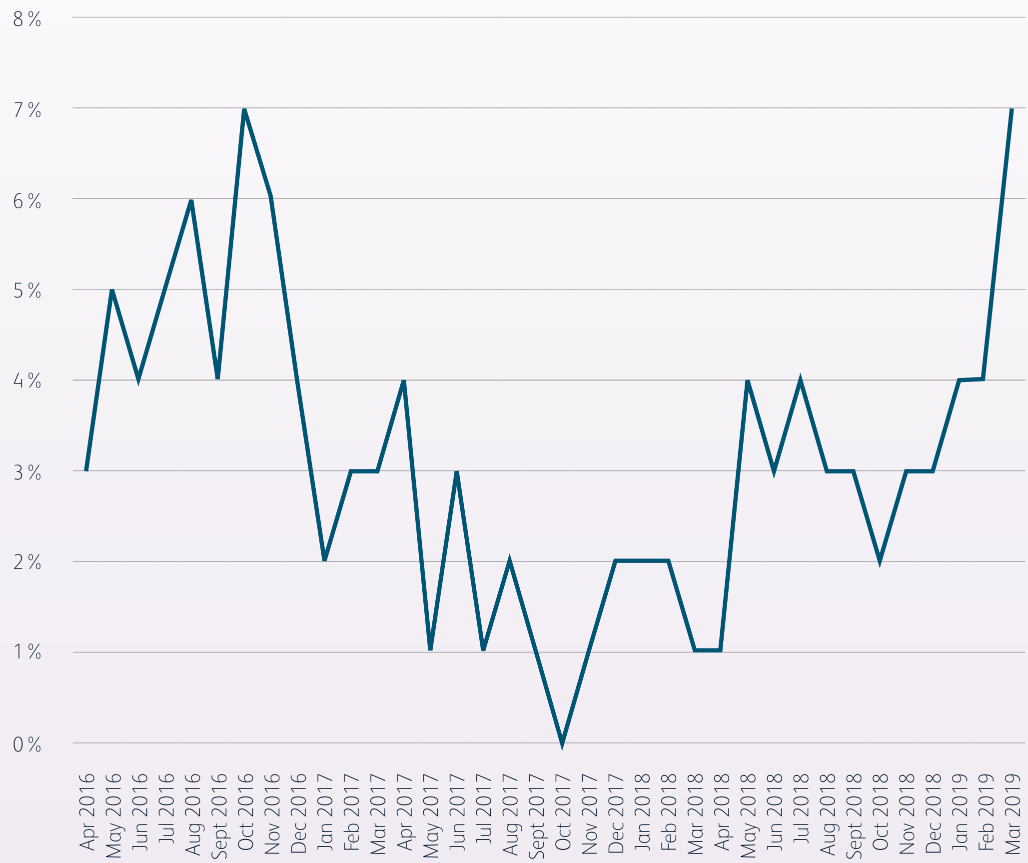
The retail sector has also been greatly affected by the high levels of economic uncertainty caused by Brexit. Consumers have been more hesitant to splurge on retail goods, and are more likely to put their money in savings accounts in preparation for an unexpected economic shock. Money saved in cash and deposits by households increased by £5.3bn in February 2019, up from £1.9bn in January.[5] This highlights the unwillingness of many individuals to spend money that could be saved in the run-up to the would-be Brexit date in March.

The retail sector also relies on a large EU migrant workforce, and retail businesses may struggle to recruit enough workers once the UK no longer has access to the pool of EU workers. If the sector is forced to increase wages in order to attract enough workers then it would impact the profitability of many companies in an already struggling sector.

In the year to March 2019, the volume of retail sales grew by 6.7 % , the highest growth rate since October 2016. This was a considerable surprise to the upside, highlighting that, despite many headlines of store closures for failing retail businesses such as Debenhams and LK Bennett, consumers are still spending, particularly online. It's important to note that a significant part of the strong annual growth figures can be attributed to the base effect of very weak retail sales in March 2018, due to the disruption associated with the Beast from the East. Cebr forecasts that overall, retail sector growth will slow in 2019, to 2.3 % annual output growth, down from 2.8 % in 2018.

[5] Source: Bank of England

Figure 7 - Annual growth in volume of retail sales



Source: ONS, Cebr analysis

Construction

Output growth in the construction sector slowed over the course of 2017, and contracted in Q1 2018. In Q4 2018, annual output growth stood at 0.3 %. The sector has been affected by a reduction in demand for new buildings as Brexit uncertainty has caused potential projects to be put off. After Brexit, the industry is likely to suffer from decreased access to EU markets. This means that imported components of the construction process could be more expensive, and that labour cannot move to the UK for work in the construction industry so easily.

Another challenge for the construction sector would be a significant depreciation of the pound because of a no-deal Brexit. This would cause import prices to increase, thereby raising costs for businesses and causing profits of construction companies to fall.

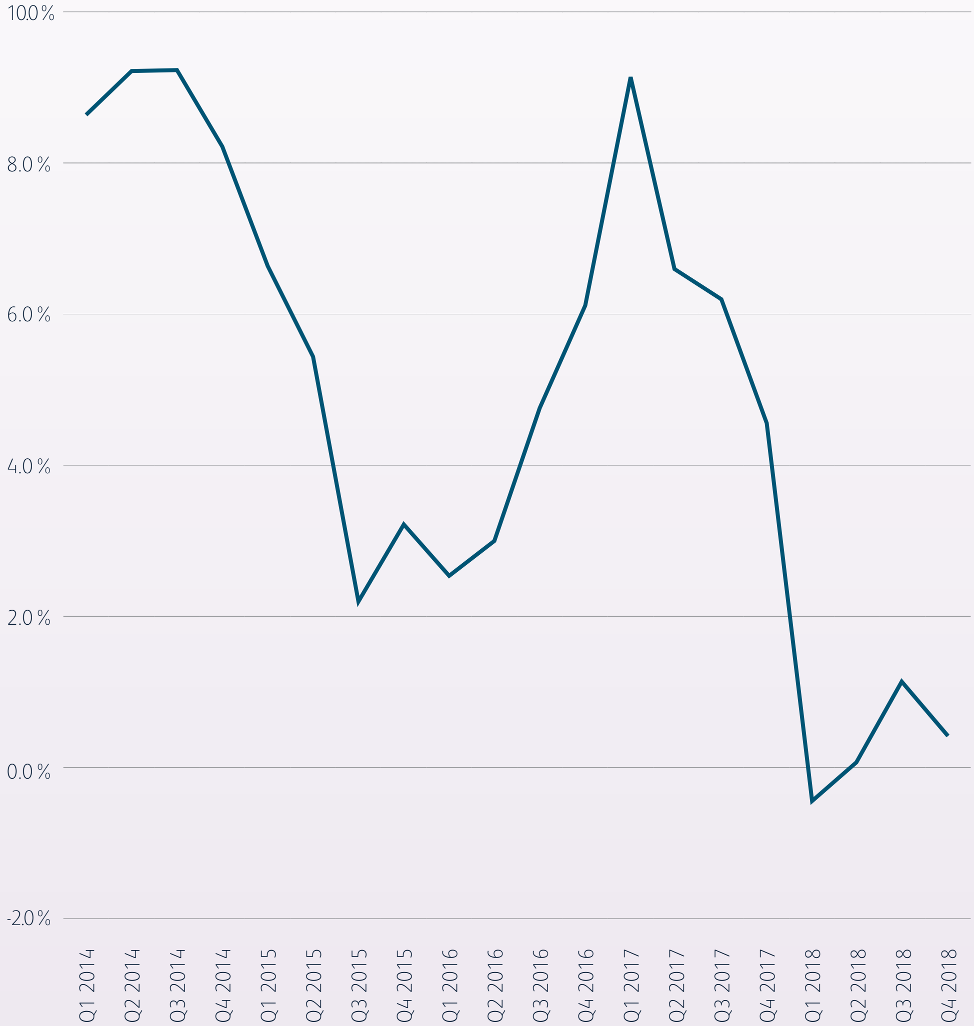
In 2019, Cebr forecasts that construction output will grow by 1.2 % on an annual basis, up from 0.3 % in 2018. While Brexit presents challenges for the industry, we expect a slight acceleration of annual growth in 2020, to 1.7 %. Despite issues, there are also opportunities for the sector. Brexit could remove regulation red tape, currently mandated by the EU, making construction a more straightforward process.

Brexit may affect construction of different types of property in different ways. According to Capital Economics, the prospect of a no-deal Brexit foreshadows a drop of 5-9 % in commercial real estate values. Meanwhile, the Bank of England predicted that a no-deal Brexit scenario could, in the worst case, precipitate a 35 % drop in house prices. These reductions in the value of property would have a significant impact on the demand for new construction, and the willingness of property developers to build, knowing they face lower selling prices. This has a significant impact on the industry.

Other construction types, such as student accommodation, could be affected by changing demand for types of property. There are around 135,000 non-UK, EU students in UK universities.[6] While current students, and those starting university this year, will continue to be treated the same as home students, it's likely that the treatment of EU students will change over the coming year. This could make them less likely to apply to study in the UK.

[6] Source: https://www.bbc.co.uk/news/education-44676843

Figure 8 - Annual growth in output of construction industry



Source: ONS, Cebr analysis

Financial and business services

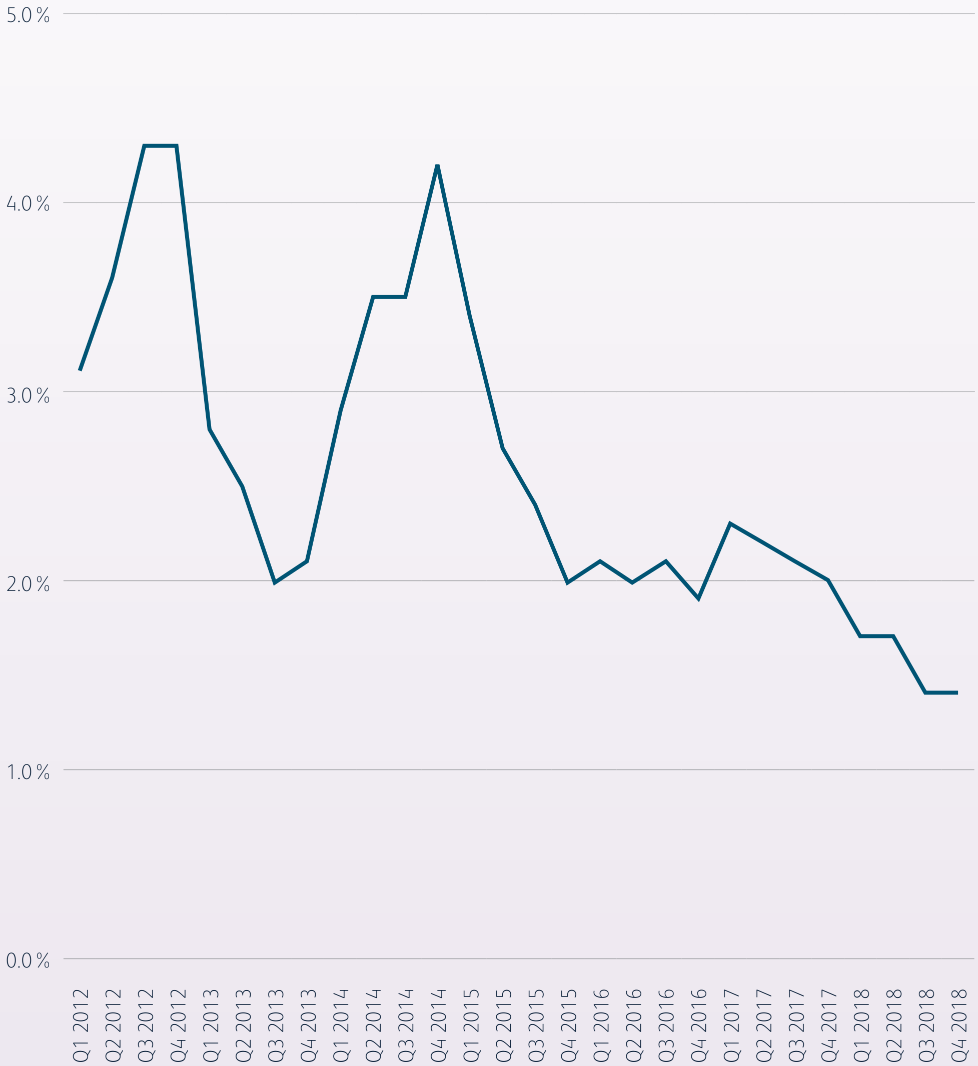
The financial services sector is one of the most important industries in the UK. It contributes £115bn to the economy, which is equivalent to 6.5 % of total output. The sector is highly concentrated in London, which accounts for around half of the UK's financial services output, the South East and Scotland.

Given the importance of financial services for the economy, there's been a great deal of speculation about what the impact of Brexit will be on the sector. One key way that Brexit could impact the sector is through the labour market. It's highly likely there'll be a certain number of staff relocated from the UK to other EU countries as companies prepare for the regulatory changes that will follow Brexit. Many companies have a subsidiary in an EU country (or are willing to set one up) and could decide to shift capital and staff from the UK towards their EU presence(s).

If the size of the financial and business services sector in the UK shrinks as a result of some operations being relocated to the EU, it would be likely to cause an impact on government revenue. Tax receipts from the banking sector amounted to £28.5bn in the 2017-18 financial year, some of which could be lost as a result of businesses relocating their taxable assets.

One of the most widely discussed issues is that of the loss of passporting rights. Currently, companies in EU member states, and non-EU states that are members of the European Economic Area (EEA), can sell their services freely within the bloc. But this will no longer be the case when the UK leaves the EU. Equivalence is the most likely solution to the issue. It means EU regulators will recognise UK institutions and systems as equivalent to those in the other 27 countries in the trading bloc, but many are concerned an equivalence agreement would mean the UK would end up in a rule-taking scenario.

Figure 9 - Annual growth in financial and business services GVA



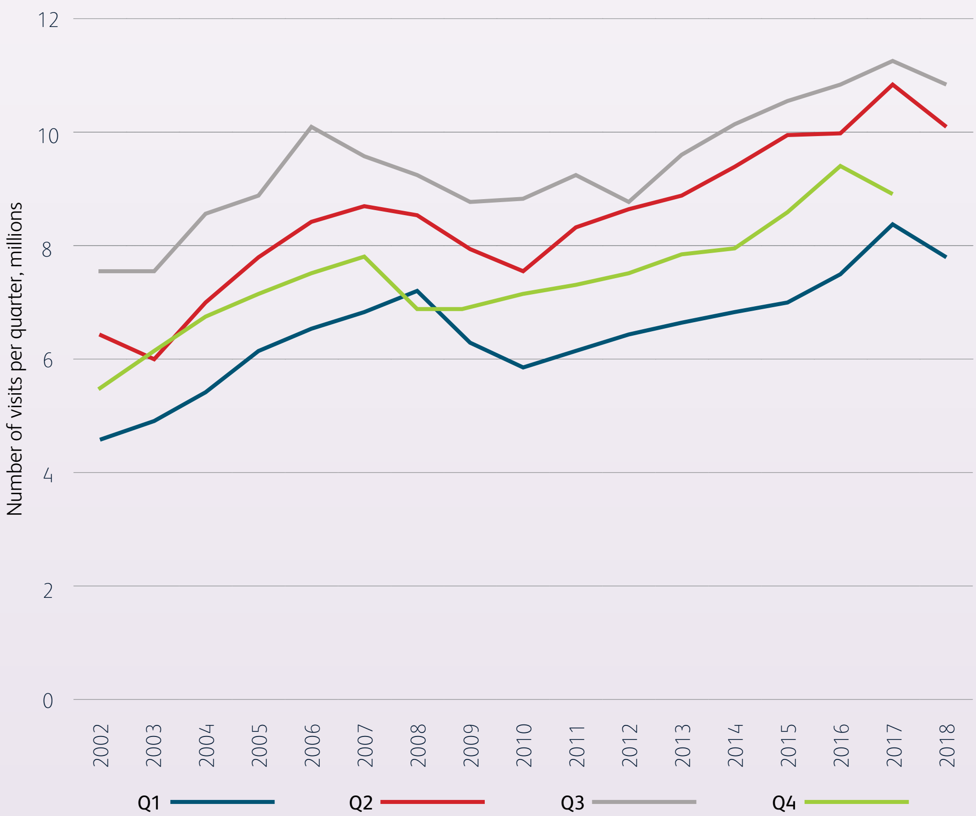
Source: ONS, Cebr analysis

Hospitality

The hospitality industry is made up of enterprises that provide accommodation, meals and drinks in venues outside of the home. The output of this sector can be heavily affected by the number of visitors to the UK.

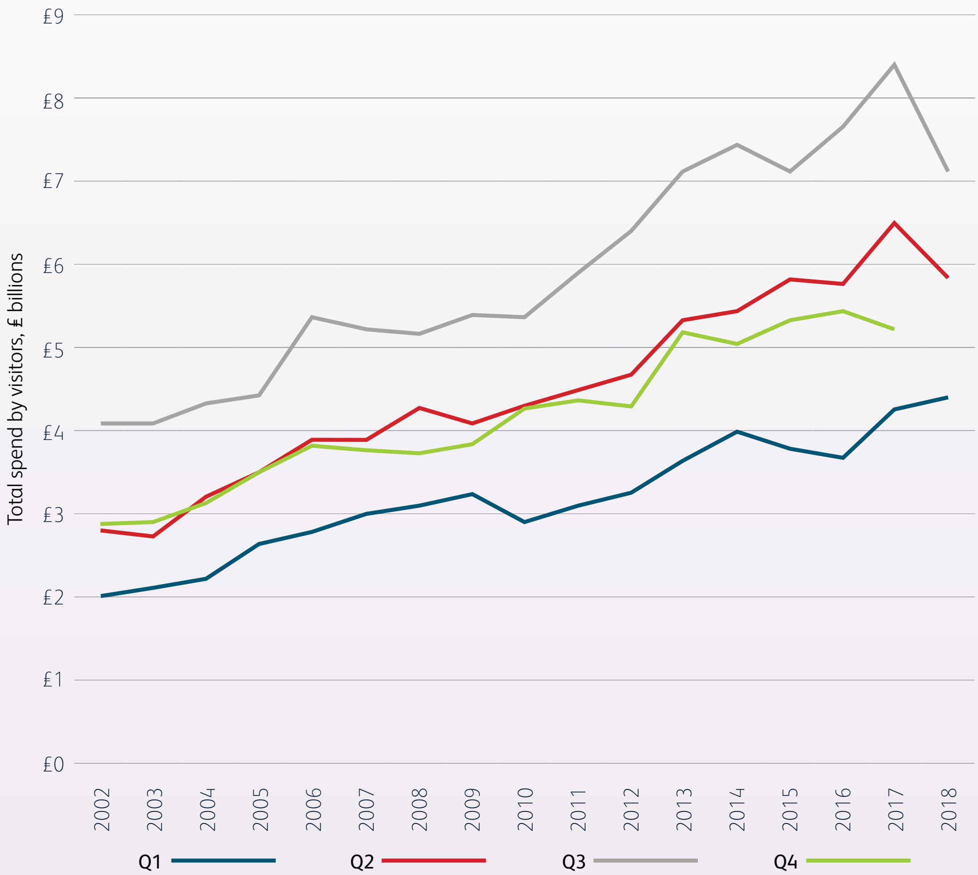
Visit Britain data shows that the number of visitors to the UK in 2018 fell compared with 2017. Between July and September, the quarter when visitor numbers are highest, there were 10.8m visitors to the UK in 2018, down from 11.1m in 2017. Meanwhile, the total spend by visitors fell to £7.2bn in Q3 2018, down from £8.4bn in 2017. While the cause of the reduced visitor numbers will be related to various factors including a global economic slowdown, it's likely that some potential visitors were put off by uncertainty related to Brexit and chose to visit other countries instead.

Figure 10 - Number of visits to the UK from abroad



Source: Visit Britain, Cebr analysis

Figure 11 - Total spend by visitors to the UK from abroad



Source: Visit Britain, Cebr analysis

Overall, Cebr expects output in the accommodation and food services sector to expand by 2.3 % annually in 2019, down from 2.8 % in 2018. Following Brexit, the sector will be affected by more limited access to workers from the EU, who currently make up 13 % of employees in the sector. In order to attract workers, businesses may have to pay higher wages, which would likely mean that they have to raise prices in order to afford the increase in labour costs.

The hospitality sector relies on a significant amount of foreign investment. After Brexit, there's a risk that this investment is reduced, as under a no-deal scenario the UK could be seen as a riskier location for business. On the other hand, if the pound weakens further, it could make the UK a more attractive location as investment may be cheaper.

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Methodological Note

All forecasts in this report utilise Cebr's central scenario. Cebr's central forecasts are based on the assumption that an amended version of the Brexit withdrawal agreement will form the basis of the future UK – EU relationship. We further assume that a transitional arrangement will be put in place that allows a continuation of the current relationship without any major disruptions until at least 2021. On the immigration policy, we rely on the lower immigration population estimates assuming that a visa system will be implemented for EU nationals, but that the requirements (e.g. the minimum salary, the NHS surcharge payment, the application fees, etc.) would be more relaxed than they currently are for non-EU nationals requiring a visa.

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