Brexit watch

Fortnightly briefing on Brexit developments

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It took months to see draft agreements during phase one of negotiations, however phase two is a different beast. The draft withdrawal agreement released by the European Commission at the end of February was quickly followed by the EU negotiation guidelines. A number of clarifying speeches were given by front bench members of the UK Government, and strong reaction from both sides suggests agreement is still a way off from agreement.

However, Brexit is little if not surprising and a joint Draft Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community was published on Monday. Representatives on both sides confirm that 75 per cent has been agreed, but further negotiation is required to finalise the remaining 25 per cent.

The agreement is seen as an early win for the EU, with the UK conceding on a number of points critical to both its industries and citizens. One such issue that has sparked considerable reaction is fisheries. It was promised by UK representatives, including Environment Secretary Michael Gove, that the UK will achieve full control of its coastal waters as soon as Brexit is enacted on March 29th 2019. While the agreement ensures the UK will be consulted as part of the 2020 EU fisheries agreement, it will have limited control until the transition period is seen through.

As could be expected, this is a sticking point in the UK, particularly among Scottish politicians who have come out strongly against the acquiescence.

The agreement reiterates the pressure on the UK to compromise if it wants to make progress with the EU. Regardless of negative reception, this was an important stage to complete, as it affords UK negotiators time to now discuss the future trade relationship – a key concern for business.

On Wednesday, the ESRI released a report on Brexit and Irish Consumers which finds that a hard Brexit scenario – that is one with WTO tariffs - would increase the cost of living by between 2 per cent to 3.1 per cent, with a disproportionate impact expected on lower income households. This equates to an annual increase of €892 to €1,360 per household and adds to the growing body of forecasts predicting high negative effects of a hard Brexit on Ireland. The report points out that the impacts do depend on how domestic supply reacts and the possibilities for product substitution, both of which are hard to quantify.

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1 Political developments

Ireland

Concrete border discussions to start 'as early as next week' in effort to keep issue at the fore of discussion

The transition agreement has secured the 'backstop' plan whereby Northern Ireland remains in regulatory alignment with the Republic of Ireland should a superior trade deal not be reached. Simon Coveney has said the preferred option will always be a future relationship that is close enough to avoid implementation of such a backstop.

In response to the provision, Tánaiste Simon Coveney said the Government would 'enthusiastically' support any future trade arrangement that avoids a hard border, so long as it is 'comprehensive enough'. The Tánaiste emphasised that arrangements secured in the latest agreement will not allow the issue of an open border to be 'kicked into the long grass.' This was an important statement as coverage focused heavily on the backstop agreement which is the least preferred option of the Irish Government.

Meetings to address the final legal wording will begin as early as next week according to Mr Coveney.

Irrespective of a lack of concrete legality, the transition agreement is a decisive win from the perspective of the Irish Government. Merely three weeks ago, Theresa May opposed a fall back of full regulatory alignment, saying 'no United Kingdom prime minister could agree to it.'

The DUP, currently propping up Mrs May's Government, is fiercely opposed to any regulatory divergence with the UK but has been relatively quiet on this development. Some commentators suggest this alludes to a contrast in how the involved parties are interpreting 'full regulatory alignment.'

Fianna Fáil, seeking to hold Government to account, rebuked by Tánaiste for flip flopping on stance

Fianna Fáil's Stephen Donnelly criticised the Government's role in recent developments during leader's questions in the Dáil on Tuesday. The TD suggested the backstop will cause the border issue to 'become just one of many competing priorities' once trade talks begin and that the problem has essentially been pushed down the road.

In response, Fine Gael's Simon Coveney accused Fianna Fáil of changing its position 'from one of consultation with the Government to one of trying to find ways of undermining and criticising what the Government is trying to do.' Mr Donnelly said his party's support of the Government internationally does not preclude it from holding negotiators to account 'when [they] see no progress being made.'

Economic Performance

Recent Statistics

European Union

Available from EuroStat

- Q4 2017 employment up 0.3% on Q3 in the euro area and up 0.2% in the EU 28. The year-on-year increases were 1.6% and 1.5% respectively
- Jan 2018 figures show a month-on-month decline of 1.0% in industrial production across the euro area. The same indicator was down 0.7% in the EU 28
- Production in construction (Jan 2018) down by 2.2% in euro area and 2.1% in EU28 against Dec 2017

Great Britain

Available from the ONS

- The Consumer Prices Index including owner occupiers' housing costs (CPIH) 12-month inflation rate was 2.5% in Feb 2018, down from 2.7% in Jan 2018
- The Consumer Prices Index (CPI) 12-month rate was 2.7% in Feb2018, down from 3.0% in January 2018
- UK GDP in volume terms was estimated to have increased by 0.4% between Quarter 3 (July to Sept) and Quarter 4 (Oct to Dec) 2017

Republic of Ireland

Available from the CSO

- Preliminary figures for 2017 GDP and GNP stood at 7.8% and 6.6% respectively
- Balance of Payments for 2017 recorded a current account surplus of €37.1bn
- Preliminary figures for Jan 2018 show that seasonally adjusted goods exports grew by €1.7bn (+16%) to €12.3bn from Dec. Imports decreased by €67m (-1%) to €6.8bn which gave a seasonally adjusted trade surplus of €5.5bn in Jan (+46% on Dec)
- The Labour Force Survey for Q4 2017 shows employment up 3.1% q-o-q to 2.2 million persons.

Northern Ireland

Available from NISRA

- The Nov 2017 to Jan 2018 unemployment rate stood at 3.2%, down 0.8% q-o-q. This is the joint lowest rate on record
- Seasonally adjusted employment rate for NI from Oct to Dec 2017 was 3.9%, the joint lowest figure since 2008
- The economic inactivity rate (28.4%) decreased over the quarter by 0.5 percentage points and increased by 2.3 percentage points over the year
- The volume of construction activity increased by 1.2% from Q2 to Q3 2017. The year-on-year increase was 11.3%

1 Political developments

Transition Agreement Secured

On Monday it was confirmed that the EU and UK agreed a 'large part' of the transition agreement. The agreement will subsequently lead to the orderly withdrawal of the UK from the EU. The latest developments have paved the way for negotiators to move onto discussions on the future relationship.

EU wins

- The UK will adhere to a 'legal backstop' plan whereby Northern Ireland will remain in full regulatory alignment with the Republic, and therefore the EU generally, to avoid a hard border
- All aspects agreed as part of the transition agreement will only come to fruition if the withdrawal agreement is completed and addresses issues with the Irish border and Northern Irish alignment
- The UK will abide by all existing and new EU laws during the transition but will not have the authority to contribute to debate or voting on new legislation
- EU citizens who arrive in the UK during the transition period will hold the same rights as those who arrive before Brexit, in terms of residency
- The UK will be subject to the EU fisheries agreement throughout the transition period

UK wins

- A 21 month transition period has been agreed during which time the UK will have full access to EU markets
- The UK will have authority to negotiate and agree new trade deals with third countries during the transition, something they currently cannot do
- The UK will receive consultation rights when new EU fishing quotas are set in 2020 and has a guarantee that the EU will not reduce its share of the total catch
- The UK has choice on its involvement in EU's foreign policy and defence initiatives

Reaction

Business

In reaction to the news, sterling rose above $1.40. This was the highest value since the 16th February showing the markets appreciated the developments in the agreement, however it was mainly a recovery of recent losses. Many businesses have welcomed clarity which will inform their preparations for post-Brexit regulatory change.

UK

The Confederation of British Industry's responded positively: '[The transition] brings a welcome gift of time for firms on both sides. While some sectors may need more than 20 months to prepare for post-Brexit life, this is a victory for common sense that will help protect living standards, jobs and growth. It shows what can be achieved when people and prosperity are placed above politics and ideology.'

First Minister of Scotland, Nicola Sturgeon, found the deal to be a 'massive sell-out of the Scottish fishing industry' as it has not met previous promises by the Government that the UK will control its own coastal waters from the first day of Brexit. Environment Secretary, Michael Gove, made earlier assurances of UK control of its waters during the transition.

The outcome was met with ambivalence from members of the Government. Leading Eurosceptic backbench figure, Jacob Rees-Mogg, felt it was 'hard to see what points the Government has won' but that it could be accepted should it lead to a 'clean Brexit.'

The Chairperson of British in Europe, Jane Golding, highlighted the lack of clarity for Britons abroad with respect to free movement and service provision. There has yet to be confirmation on whether Britons living in the EU can move freely and avail of services in other EU countries, besides their own residencies, particularly if they are cross-border commuters. Ms Golding said 'as things stand, after Brexit, English cheddar will have more free movement rights than we will.'

Northern Ireland

The Northern Ireland Affairs Committee in the House of Commons released 'The land border between Northern Ireland and Ireland' – a report which raises the Committee's concerns on a lack of progress in determining a post-Brexit border solution. It also recognised the current absence of a technological solution which avoids physical infrastructure at the border.

The report recommends the Government should 'set out in detail how it proposes to manage immigration through internal controls', 'clarify how the Common Travel area protects the special status of British and Irish citizens in each other's countries' and 'conduct an impact assessment for the border each time regulatory or tariff divergence from the EU is proposed.'

It is important to remember that although the issue is complex, a future trade relationship where close regulatory alignment is maintained will negate the need for such an involved solution to customs. Such negotiations will begin in the coming weeks.

2 Economic Updates

Current Account Balance shows Irish surplus with the UK for 2017

Last week, the CSO released Q4 and preliminary annual results for the national accounts and balance of payments for 2017. While full detail of 2017 statistics will not be available until the summer, figures were provided to show a current account surplus with the UK, and a continued upward trend in the trade surplus.

No tariffs or trade restrictions have yet to be applied, however a weakened sterling has still posed a challenge to Ireland as a trading partner given the relative decrease in competitiveness of Irish exports. With this in mind, we look at the current account balance between the Republic and the UK over time, and how Brexit may or may not be affecting this.

What determines the current account balance?

What exactly does the current account balance with the UK measure? As per the CSO's definition, the current account balance 'consists of trade in merchandise and services, as well as primary and secondary income account inflows and outflows. The capital account covers capital transfers and the acquisition and disposal of non-produced, non-financial assets.'

Trade and income balances are therefore the key elements to determine the current account balance with another trading partner.

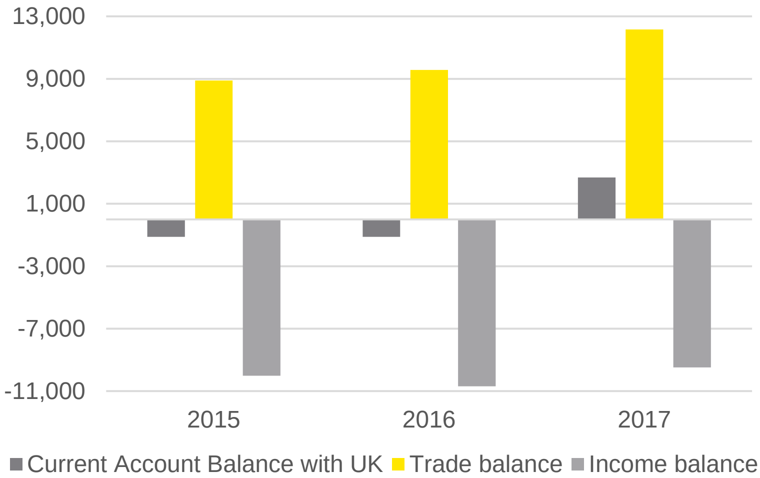
Figure 1 depicts how the trade and income balances have offset one another resulting in current account deficits in 2015 and 2016, however 2017 is showing a current account balance of €2.7bn - the first surplus since the Brexit referendum was held.

The trade surplus reached €12.2bn in 2017 with an income balance deficit of €9.5bn.

A number of factors have contributed to the 2017 surplus. One of the most notable, and which has impacted both the national accounts and balance of payments, is the variation in IP trade.

2016 saw a high level of IP imports from the UK, negatively impacting the trade balance on Ireland's side. As these imports have decreased greatly to 2017, the balance has moved in Ireland's favour. Strong growth in the export of computer services has also added to this.

Figure 1: Ireland's Current Account Balance, Trade Balance and Income Balance with the UK, 2015 – 2017



Source: CSO

Does it matter in the context of the upcoming trade talks?

Given what the current account measures, a 2017 surplus with the UK indicates that Ireland benefitted from open trade with its neighbour to a greater extent than the UK did with Ireland. However, considering that the trade surplus means Ireland exports more to the UK more than we import, there are strong concerns surrounding tariffs on Irish goods under a hard Brexit scenario. Ireland is more dependent on the UK buying our goods than the reverse which is a threat to Irish trade should tariffs reduce the competitiveness of Irish goods in the UK market. Therefore, it is important that a sufficient trade deal is achieved to avoid a hard Brexit. It is worth noting that a 10 per cent swing in the currency has not resulted in major reductions in trade flows and many tariffs will be below this. Non-tariff costs have the potential to be high also.

Other points to note from the figures

The CSO Balance of Payment figures are preliminary, however the most recent release gives a breakdown of the headline numbers. Computer services exports represented the highest proportion of services exports by euro value at €7.3bn. Imports of these services from the UK measured at €0.2bn over the time period meaning this element contributed strongly to the trade surplus. Financial services exports followed at €5.3bn, with imports again much lower at €0.7bn. Ireland has a trade deficit in the area of tourism and travel services, however the extent of the deficit narrowed from €348m in 2016 to €160m in 2017.

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