EY DKM

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Brexit watch

Monthly briefing on Brexit developments

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Our deal outcome probabilities reflect yet another tumultuous month for Brexit, with the no-deal probability increasing since the last issue of Brexit Watch. The British Prime Minister promised to step down if MPs had approved her deal. Despite this, all 12 indicative votes were rejected by parliament and meaningful vote three failed to pass.

Prior to the indicative votes, Tory MPs stated that they are not binding on the government and could possibly be ignored, essentially defeating the purpose of allowing other MPs and parties to shape the deal and garner support.

While the past two and a half years have yielded fruitless results for a Brexit outcome, the whole issue is now expected, and indeed needs, to be solved within a maximum of 10 days. The British Labour Party, on the back of public demonstrations in the UK, have continued to call for any deal to be put to a vote by the British people. However, they continue to fail to provide any solution to the current stalemate other than a people's vote. The call for the public to ratify any Brexit deal was mirrored in the second tranche of indicative votes, reaching 280 for the 'ayes' and 292 for the 'nays'.

The rejection by MPs of the third meaningful vote and failure to reach a consensus on any alternative path forward signify that the UK could very well be heading towards a no-deal Brexit. However, this is not the first time that a no-deal Brexit has looked likely, only for an eleventh-hour change to be made to temporarily avoid such an outcome.

Of course, businesses and small businesses in particular, continue in a state of limbo. With varying exit dates remaining in play, it is almost impossible to make any investment decisions or plan for the future.

1 Political Developments

United Kingdom

Crucial Commons votes

Last month three votes took place in the House of Commons. The outcome of the three votes was as expected, Theresa's May's deal was voted down again, politicians voted against a no-deal Brexit and they also voted to extend the Brexit date in the event of a no-deal scenario come 29 March. It is important to remember the series of votes do not completely remove the possibility of a no-deal Brexit. The EU agreed to extend the timeline. However the caveat was that Theresa May's third meaningful vote would be passed by parliament. The plan extended Brexit past 29 March with MPs voting on Theresa May's deal; if the deal was passed Article 50 would have been extended to 22 May, however, as the deal failed the official date is now 12 April – and the UK must also decide if it intends to partake in the European elections. If the UK announces it will hold EU Parliamentary elections by 11 April and manages to indicate a way forward, the EU might consider a 'long extension', potentially until the end of 2019 or beyond. While Ireland has welcomed the extension, the Democratic Unionist Party has outlined that its position has not changed and they did not back the deal.

Indicative votes take place

A number of indicative votes took place over the last week. The votes allowed MPs to express a preference for which version of Brexit they might prefer. The votes are not binding on the UK Government and the International Trade Secretary, Liam Fox, outlined that the government could ignore MP's views if it goes against the Tory manifesto. All 12 votes failed to reach a majority and were rejected by parliament. Theresa May promised to resign if parliament approved her third meaningful vote, however this has not materialised.

The Labour Party and a public vote

Keir Starmer, Labour MP, has said that the Labour Party is now clear that any deal should undergo a confirmatory referendum. Starmer outlined that if the third meaningful vote had passed in the House of Commons, it should also have been put to the public. This is a further move by the Labour Party that lacks a meaningful input to the current Brexit negotiations, other than put the vote to the people and hope they vote against the deal and Brexit goes away.

Countdown to Brexit

10Days

Ireland (NI & ROI)

ESRI Brexit update

Last week, the Economic and Social Research Institute (ESRI) outlined that Brexit was already having an effect on spending, investment plans and bank lending to SMEs. The ESRI also revised their GDP forecast with GDP now expected to reach 3.8% this year - down from 4.2% in earlier projections. Both the Department of Finance and the ESRI forecasted that over 10 years the economy will continue to expand regardless of the final Brexit outcome. However, GDP is expected to grow at a slower pace than in a no Brexit scenario. The ESRI also estimated that 10 years after Brexit, employment in Ireland will be approximately 45,000 lower than it would have been in a no Brexit scenario; this would increase to 80,000 in the event of a no-deal Brexit.

Impact of Brexit on Ireland's small businesses

Dr Jane Bourke, Senior Lecturer in economics at University College Cork has outlined that Brexit will impact Ireland's small businesses and the magnitude of the impact will vary across sectors. Dr Bourke outlined that small and micro businesses account for 85% of all Irish enterprises exporting to the UK. She further outlines that 1 in 3 SMEs have either postponed or cancelled potential investment plans as a direct result of Brexit. The longer the Brexit process is dragged out the longer businesses may go without much needed investment.

Europe

Jean-Claude Juncker speaks about Brexit negotiations so far

On the back of the extension offered by the EU, the European Commission President confirmed that they had done everything they could to get it over the finishing line. Mr Juncker said, "*we were asked for clarifications in December, we gave it to them. We were asked for assurances in January, we gave it to them. I was asked for further reassurances last Monday in Strasbourg, notably with regard to the backstop, I gave it to them*." The extension plan proved to be divisive at a European level with a split between a hard-line group, led by France, wanting the UK to choose between the Withdrawal Agreement or no-deal; and another group, led by the Netherlands and the Nordics, who wanted more flexibility.

2 Brexit and Regional imbalance

John Daly
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Inequality at the heart of Brexit Vote

Since the 2016 Brexit referendum, an endless number of political commentators and pollsters have speculated over the reasons why Britons voted the way they did, with factors such as immigration and sovereignty often cited as the main driving forces.

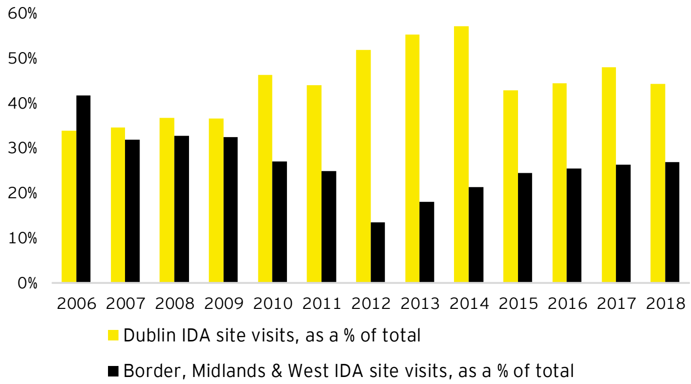
Whilst these factors no doubt played their part in the ultimate result and will offer lessons for policymakers in years to come, one factor in particular offers a key lesson to Ireland, namely the stark regional inequality at the heart of Brexit. Ironically, the regional imbalance that contributed to the leave vote may indirectly lead to a widening of regional disparities in the Republic of Ireland, potentially impairing economic growth, competitiveness, and regional development.

Location, Location, Location

Ireland has experienced exceptional economic growth since the onset of the recovery. In each of the past five years, the Irish economy has consistently experienced the fastest rate of growth in the EU, furthermore labour market conditions have progressively improved and households' disposable income has risen. However, despite such improvements, it is also generally accepted that the recovery has not been as broad-based as it could have been.

The latest CSO figures show that employment across the Republic of Ireland rose by over 50,000 in 2018, with just over half based in Dublin. Notably, the gap between Dublin, which has the lowest average commercial vacancy rate, and Connacht, which has the highest rate, has widened significantly in recent years, rising from 0.8 percentage points in Q4 2014 to 4.1 percentage points in Q4 2018. As per the latest 2015 data, disposable income per head in the Borders, Midlands and West (BMW) region is 26% below the value in Dublin, an increase of almost 10 percentage points relative to the mid-2000s. Furthermore, 44% of all 2018 IDA sponsored site visits made in the Republic of Ireland were located in Dublin, a sharp contrast when the capital represented, on average, 25% of total site visits between 2003 and 2007.

Figure 1: IDA Site visits, as a % of national total



Brexit may worsen regional imbalance

Therefore, while the economy begins the year from a position of strength, these trends suggest that regional imbalance remains an issue in Ireland. Given the events of recent weeks, the prospect of a no-deal Brexit occurring remains a real possibility, and while such a scenario would impact the entire island of Ireland, its repercussions would be acutely felt in some regions more than others.

Sectors such as Food and Beverage, Accommodation and Tourism Services, Manufacturing, and Agriculture, which are extremely exposed in the event of a hard Brexit, are also the same sectors that drive growth in regions outside of the Greater Dublin Area. The GeoView Commercial Report Q4 2018 shows that counties on the west coast have the highest proportions of commercial units involved in the Accommodation and Food Service sector, most notably in Kerry (23.5% of units based in this sector), Clare (20.3%) and Donegal (19%). Likewise, the ten counties with the highest proportions of commercial units involved in traditional manufacturing were predominantly based in the BMW region, with Monaghan (7.1%) recording the highest share. At the same time, Dublin is less reliant on these sectors with Brexit actually presenting a number of opportunities for the capital, given the potential influx of financial services firms into the city. On this basis, a no-deal Brexit would likely widen current regional inequalities in Ireland.

Project 2040's success is vital

Such risks reinforce the need for more inclusive growth, while also highlighting the importance of Project 2040. In this regard, integrated public transport, a high quality broadband network, policies that reflect local strengths and the expansion of regional economic hubs will help to rebalance growth. Therefore, if one positive can be found in the midst of Brexit, let it be the lesson that regional solidarity is instrumental to national progress.

3 Business developments

Uncertainty continues but shorter delay signals end in sight

Once the political noise is set aside, little has changed for businesses in the past month. One concrete development that businesses can use to guide their planning is that Brexit is now potentially occurring two weeks later than planned, on 12 April. This may comfort firms as efforts are being made to avoid a cliff-edge conclusion to negotiations, but is a much narrower window than the three months which were sought. Businesses must use this additional time to hone their contingency plans and to ensure they are as prepared as possible for a no-deal exit on 12 April. Whilst the business community hopes for a better outcome, this remains the legal default should other options be exhausted.

Table 1: Deal probabilities

	Likelihood	Change since last issue
WTO (no-deal)	30%	More likely
FTA	10%	Less likely
Single market + customs Union	5%	Unchanged
Hybrid arrangement	35%	Less likely
Remain in EU/EEA	20%	More likely

Source: EY Estimates

Resilient despite the headwinds

The coverage surrounding Brexit and its effects on the domestic economy is overwhelmingly negative, and the prevailing low self-reported confidence amongst businesses and consumers is a manifestation of this.

Whilst Brexit presents a set of challenges, it is a mistake to dwell on this. It is worth noting that the global economy in general has entered a more challenging period. The Eurozone's third largest economy, Italy, entered recession in 2018, recording a contraction of 0.2% in the final quarter. Furthermore, the IMF's 2019 global growth forecast was downgraded by 0.2% to 3.5% in January 2019.

In spite of this, the domestic economy has proved resilient to global conditions. Northern Ireland's Gross Value Added growth outpaced that of the UK's in the year to Q3 2018, growing 2.1% and 1.5%, respectively. The ROI economy is also standing firm. Recent figures from Ireland's Foreign Direct Investment Agency demonstrate that 70 business investments related to Brexit, bringing with them in excess of 5,000 new jobs, have been made since the referendum. This stands to increase, potentially exponentially, following 12 April.

A deal is the optimal outcome for all EEA economies and businesses

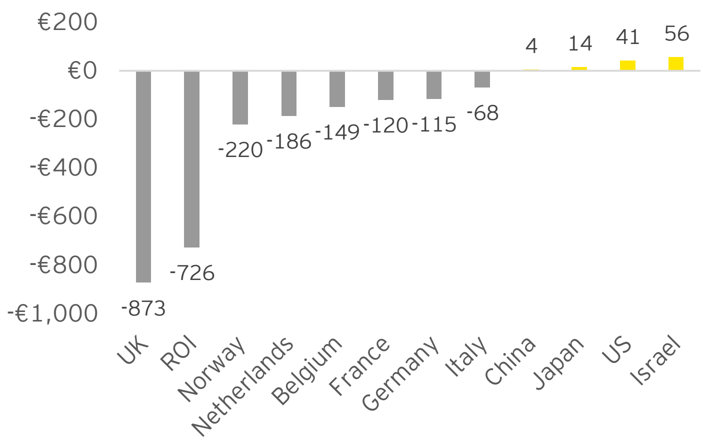
March saw the release of a report from German thinktank Bertelsmann Stiftung which focused on the productivity, mark-up and welfare effects of both a hard and soft Brexit. Unlike similar studies which have preceded it, this was unique in its breadth of scope, encompassing not only EU and EEA countries, but also those further afield such as the USA and China.

The study's overwhelming conclusion was that a no-deal Brexit would have negative consequences for all EEA countries, and as such a deal is in the collective interest, not just that of the UK. This reinforces Angela Merkel's recent comments that an orderly Brexit is "not just in the U.K.'s interest ... but it is also in the German interest" and thus she will "fight until the last minute" for a deal.

The study testifies to Merkel's logic. Using a model which incorporates trade barriers, a mobile workforce and variety within firms and products, it cites German economic losses resulting from a no-deal at €9.5 billion per year. France would also lose sizeably, by €7.7 billion per annum. The UK would suffer the biggest losses, in excess of €57 billion per annum; however, in per capita terms, Ireland is in second place, suffering a loss of €726 per person, per annum, compared to the UK's €873.

However, as shown in figure 2, certain non-EEA nations stand to gain from Brexit-related displacement. In volume terms, the US is the largest beneficiary, gaining €13.2 billion per annum. This is followed by China, at €5.3 billion per annum. Although less covered by the press, the highest beneficiary in per capita terms would be Israel which, notably, have already signed an individual trade deal with the UK.

Figure 2: Per capita welfare change (€, per annum) resulting from a no-deal Brexit, selected countries



Source: Bertelsmann-stiftung, Estimating the impact of Brexit on European countries and regions, March 2019

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