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Brexit watch

Monthly briefing on Brexit developments

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The extraordinary Brexit summit tentatively earmarked for November has been cancelled. It is no surprise given the lack of progress in negotiations. Reportedly, 90% to 95% of the withdrawal deal has been agreed with the Irish border and backstop being one of the remaining issues that separates both sides.

The fallout from the October summit was much more sedate than the September summit with very little to report. The DUP appear to be more likely to derail any deal that could potentially result in Northern Ireland being more closely connected to the EU than the rest of the UK. With the UK budget coming up, it is perfect timing for the DUP MPs propping up the Conservative Government to make more demands in relation to Brexit.

We are now one month closer to Brexit with little progress made since the last issue of Brexit Watch. It appears from media sources that the Irish border is one of the few remaining issues. Simon Coveney stands firm, outlining that the UK has already agreed to a backstop and this should not be changed. Once an agreement has been made in relation to the border, the withdrawal agreement is expected to progress quickly. However, with talks now shifting to adding an extra year to the two-year transition period, it is becoming apparent that the Brexit negotiations could drag on for much longer than anticipated.

EY Q3 profit warnings show Q3 had the highest fall in average share prices since the financial crisis, with the retail sector suffering under increasing pressure. With continued uncertainty already affecting business confidence and investment, businesses must seek to make contingency plans that minimise both costs and damage.

1 Political Developments

United Kingdom

People's Vote Campaign

A march took place in London last Saturday, in which people urged politicians to put the final Brexit deal to a people's vote. Organisers of the march estimate over 670,000 people participated. This event is the culmination of the frustrations of UK citizens opposed to Brexit. Media outlets are reporting that 95% of the withdrawal agreement has been settled. Furthermore, Donald Tusk outlined that European leaders would respond positively to a request from the UK for an extension of the post-Brexit transition period. Initially the plan was for a 21-month transition period beginning on the 30th March 2019. Given the remaining difficulties with negotiations so far advanced into the Brexit timeline, it is possible that the UK may request such an extension, to mitigate the potential economic impacts of Brexit.

No extra summit in November

Initially it was reported that an extraordinary Brexit summit would go ahead in November, but it now appears that EU officials do not plan to proceed. The next summit will take place in early December.

Ireland (NI & ROI)

Barnier on the border

Michel Barnier outlined on France Inter Radio that issues with the Irish backstop could potentially cause Brexit talks to break down. This comes as no surprise considering both sides have been vocal on the backstop and border issue, with the EU calling for no hard border and the UK Government outlining that they will not split 'their country' in two by imposing a border down the Irish sea.

Agriculture in NI

The agricultural sector in Northern Ireland is highlighting the need for clarity in relation to Brexit. With no Executive, the sector is calling on the British Government to set out how it plans to formulate policy for the sector. Many farms in NI rely on EU subsidies and 2019 now may be the last year in which EU subsidies apply. Given there has been little progress on the border issue in the Brexit negotiations, agricultural exports could be adversely affected if a hard border is put in place.

Coveney stands firm on backstop

'There will be no withdrawal agreement without the backstop, end of story,' outlined Coveney. The ROI Minister for Foreign Affairs and Trade reinforced his point stating that the UK Government had already agreed to a legally operable backstop and to suggest moving away from that now was 'not going to fly'. Coveney's comments were in response to a statement by the UK Secretary of State for Exiting the European Union, Dominic Raab, proposing that an extension of the transition period could replace the backstop agreement.

DUP ready for no-deal scenario

Leaked UK Government emails have outlined that DUP leader, Arlene Foster, now believes that the UK crashing out of the EU with a no-deal is the most likely outcome. The DUP MPs that prop up May's Government made it known that they would vote down the upcoming Budget if any agreement was made to tie NI more closely to the EU than the rest of the UK. In a similar vein, earlier this month the DUP leader outlined that their 'red line' on the border issue was 'blood red'. Sinn Féin's Vice President, Michelle O'Neill, branded the comments bizarre and said that the DUP was not speaking for the majority in NI, which had voted to remain in the EU.

Europe

Barnier plays down Irish Sea border

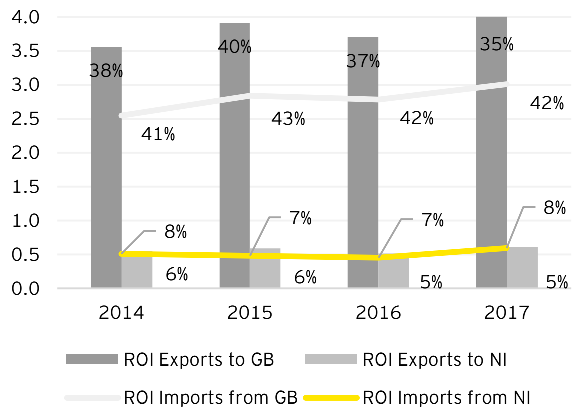
Brussels outlined that controls on goods shipped from Great Britain (GB) to NI would be required if there is to be no hard border between NI and ROI in the context of a hard Brexit. Michel Barnier said that this would not constitute a border, and there are existing mechanisms in place whereby 10% of livestock imports to NI from GB are subject to veterinary checks. Barnier added that this would increase to 100% in the event of a hard border, but could possibly be decreased to 40% with a necessary animal-health agreement.

2 Economic Developments

Agri-food trade on the island of Ireland (IOI)

Brexit discussions pertaining to the border are frequently high level in nature and focus on issues such as political and economic stability relating to the Good Friday Agreement (GFA). However, there are also a number of granular issues. If a border is introduced on the Irish Sea, it may have a negative impact on trade from GB to ROI. Conversely, if a hard border between NI and ROI is introduced it may also harm trade.

Fig 1: ROI value of Agri-food trade (€bn)



Source: CSO
*Note: Fig 1 and 2 are based on SITC CSO and HMRC international trade data divisions 00 to 09[1]

Exports

The percentage values in the chart above outline the share of GB and NI trade as a percentage of total Agri-food trade in and out of ROI. GB is one of ROI's largest trading partners in agricultural goods. ROI agricultural exports to the UK averaged €3.8bn per year from 2014 to 2017, 37% of total agricultural exports. The agricultural sector in ROI is clearly highly reliant on access to the GB market.

ROI is less reliant on the NI market for agricultural trade, with yearly exports averaging €569m, 6% of overall Agri-food exports.

Imports

A similar pattern is seen within Agri-food imports. Import value from GB as a share of overall Agri-food imports averaged 42% from 2014 to 2017 while total imports from GB as a share of total global imports represented 23% over the same period. Agricultural imports from NI represented an average of 8% of total agricultural imports from 2014 to 2017, while total imports from NI to ROI represented an average of 2% of total global imports.

ROI Perspective

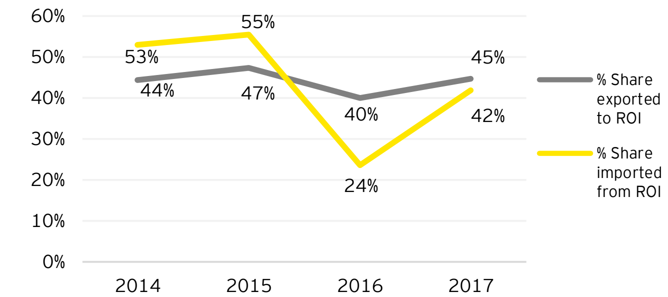
ROI is heavily reliant on GB for Agri-food trade with the British market accounting for 37% of total Agri-food export value and 42% of total Agri-food imports to ROI.

ROI is less reliant on NI for both export and import Agri-food trade which amount to 6% and 8% of total Agri-food exports and imports respectively.

NI Perspective

Northern Ireland is heavily reliant on ROI for both the Agri-food exports and imports (fig 2).

Fig 2: NI agricultural trade value with ROI



Source: HMRC & CSO

In the chart above, on average, NI exported 43% of its total export value of Agri-food to ROI over the four years, while 44% of its total Agri-food imports came from ROI.

ROI's Agri-food trade is heavily reliant on Britain, while NI's is dependent on ROI. Given the exposure of ROI to GB and NI to ROI, it is important for the Agri-food sector to contingency plan for all possible trade outcomes.

[1]00 Live animals other than animals of Division 03, 01 Meat & meat preparations, 02 Dairy products & birds' eggs, 03 Fish, crustaceans, molluscs and preparations thereof, 04 Cereals & cereal preparations, 05 Vegetables & fruit, 06 Sugar, sugar preparation & honey, 07 Coffee, tea cocoa, spices & manufactures thereof, 08 Feeding stuff for animals (excl. unmilled cereals) and 09 Miscellaneous edible products & preparations

3 Business Developments

Brexit fatigue

Each issue of Brexit Watch brings the March 2019 deadline one month closer, yet there is frustratingly little to report in terms of tangible advice for businesses. Indeed, the only real official guidance surrounds the implications of a no-deal. This has led to accusations of the UK Government letting down British businesses through its lack of preparedness. In July, Catherine McGuinness, City of London Policy Chairman, called the UK Government White Paper's lack of clarification on issues such as financial passporting 'a real blow' for professional services. She has said that the persistent uncertainty is already affecting business confidence, in both the UK and EU.

A cost-benefit approach to contingency planning

Ending the Brexit deadlock is crucial, according to the Confederation of British Industry (CBI), warning that 58% of British businesses plan to action contingency plans such as job cuts and adjustments to supply chains should no progress be made soon. 19% of businesses have already implemented irreversible plans for 'economically damaging supply chains' , and the CBI forecast that an additional 15% will do so in October, 24% in November and a further 24% in December 2018.

SMEs are expected to be disproportionately impacted by the consequences of Brexit. Their failure to prepare is in itself a strategy, according to the FT's Sarah Gordon. Firms may have analysed their operations, supply chains and vulnerability, and forecasted what mitigation strategies would cost, plus the benefit they would bring. The difficulty is that a no-deal is just one possibility, along with a Free Trade Agreement (FTA) and customs union outcomes. With no clear outcome, implementing contingency plans for every eventuality is prohibitively costly for most firms. While multinationals benefit from diversified locations and markets, SMEs do not have these resources and do not benefit from such economies of scale. 99.3% of all private sector businesses in the UK are SMEs, a pattern which is mirrored across Europe; over 99% of Irish businesses are SMEs and employ almost one third of the workforce. One option for SMEs looking to minimise sunk costs given the uncertainty surrounding the final agreement, is to consider outsourcing options for any future additional workload.

EY in-house insights

Brexit Strategy team: Current outlook

With a constant stream of political noise, there is no clear prospect which affords firms certainty. Even more confusing is the rise of calls from high-figure profiles for a second referendum and popular protests in support of this. For this reason, there has been little movement in the EY Brexit Strategy team's percentage likelihoods, aside from a slight increase (for the first time since the scenarios' inception) in the probability of remaining in the EU/European Economic Area (EEA). Until all areas of a withdrawal agreement are agreed, nothing is certain regarding an outcome, and as such firms should plan for every eventuality in a way that minimises sunk costs as much as possible.

Table 1: Current Brexit Outlook

	% likelihood (September 2018)	More or less likely since September 18?	More or less likely since referendum?
FTA	30	Same	Less
Customs Union	30	Same	More
WTO rules	25	Less	More
Remain in EU/EEA	15	More	More

Source: EY Brexit Strategy Team, October 2018

EY Capital Agenda Blog

'This is a difficult, but not dire picture' was the narrative emerging from EY's Q3 2018 UK Profit Warning Index. This quarter registered the highest fall in average share prices - 21% - since the financial crisis in 2008, and the highest ever recorded by the survey. Additionally, the percentage of FTSE General Retailers issuing profit warnings (one third) reached a seven-year high, giving no relief to this sector's woes.

On the upside, general profit warnings were down 9% year-on-year. However, this masks regional disparities, with Scotland and NI profit warnings doubling year-on-year, with London falling by 35%. Increasing costs and overheads were again the major driver behind these results. This band includes wage pressures, with increasing inflation squeezing workers' real incomes, and demand for skilled staff exerting upward pressure on wages. The contraction in real incomes has had wider consequences for the UK economy, with spending on necessities being prioritised over luxuries like restaurants and holidays. This is a foreboding sign, as consumer spending has historically 'been one of the most resilient areas of the UK economy.

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