Brexit watch

Monthly briefing on Brexit developments

Issue 41 | 10 June 2019

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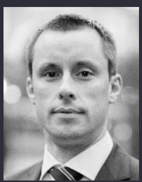

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Theresa May has officially stepped down as the leader of the Conservative Party and will soon depart as Prime Minister. As yet, it is not clear who will take her place, but it is expected to be decided by late July. Most leadership hopefuls have outlined their plans to renegotiate the Withdrawal Agreement with the EU. However, this approach is unlikely to work for two reasons, firstly the EU has said it will not renegotiate the almost 600-page deal, and secondly, Sabine Weyand, one of the chief architects of the Withdrawal Agreement, has been transferred out of the European Commission's Article 50 taskforce. This has led some to believe that resources are now being allocated elsewhere and the Withdrawal Agreement team will shortly be disbanded.

The European elections yielded no great surprises. As expected, the Conservatives and Labour suffered huge losses, while Nigel Farage's Brexit Party took nearly a third of the vote, followed by the Liberal Democrats in a distant second. It looks like Leave voters were swept up by the Brexit Party, with Remain voters split between the Lib Dems, Labour, Greens and Nationalists. The next EU council meeting will be held in late June, with Brexit currently not on the agenda. With British politics in stasis, the extra time afforded by the extension is being wasted, and the UK is currently heading towards another cliff edge in October.

The latest EY attractiveness survey suggests that the UK's difficulty has been Ireland's opportunity. FDI-related projects in Ireland received a Brexit boost in 2018, increasing by 52% on 2017. In contrast, Europe saw a 4% decrease in the number of FDI-related projects in 2018.

Elsewhere, the draft EU budget for 2020 has been released with a key focus on jobs, growth and security. 21% of the budget for 2020 will be allocated to tackling climate change. However, the budget lacks any specific mention of Brexit supports for highly exposed sectors and countries.

Political developments

01

Countdown to Brexit

143 days

United Kingdom

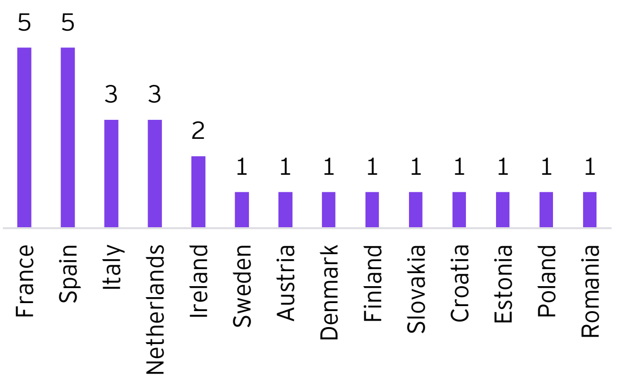
Theresa May resigns

After failing to get her Withdrawal Agreement passed by the House of Commons, Theresa May announced that she would leave office on 07 June. She stated that she had done her best and that it was now time for a new Prime Minister to lead the effort to deliver Brexit. The new PM is likely to encounter the same issues as Theresa May; no stable majority and no clear preference on which route to take, the EU no longer willing to negotiate the Withdrawal Agreement (in fact they have begun to break up the team that negotiated on behalf of the EU), and the Irish border issue.

European election results

In line with the requirements for the extension of the Withdrawal Agreement the UK contested the EU elections. Former UKIP leader Nigel Farage saw his Brexit Party top the poll with 30.7% of the vote, equating to 29 seats. The remaining parties following behind; The Liberal Democrats (16 seats), Labour Party (10 seats), Green Party (7 seats) and Conservative Party (4 seats). Labour and the Conservatives suffered the heaviest defeats losing 10 seats and 15 seats respectively since the 2014 European Parliament elections. After Brexit, 73 European Parliament seats will be vacated by the UK, with 27 re-allocated to other member states. The size of the European Parliament will be reduced from 751 MEPs to 705, with Ireland gaining 2 seats.

Post Brexit re-allocation of UK EU Parliament seats



A shift in opinion

Following on from their success in the European elections the pro-EU Liberal Democrats now top the YouGov public opinion polls. At 24% the Liberal Democrats are two percentage points ahead of the Brexit Party. Anthony Wells, Director of Political Research at YouGov, outlined that much of the poll's findings are the result of the short-term impact of the European election results.

Ireland (NI & ROI)

Tánaiste says new PM will face same issues

On the back of Theresa May's resignation, Tánaiste and Minister for Foreign Affairs, Simon Coveney has said that the issues thrown up by Brexit will not change as a result of a new Prime Minister. He further added that protecting the peace process, customs union and single market are issues that have been there from the beginning and will not change. Mr Coveney also reiterated that the EU position will not change.

DUP could pressure new PM

The DUP, who commit to supporting the Conservative government on key votes, could lobby the new PM to seek alternative arrangements to the backstop. The DUP has been openly critical of Theresa May and the backstop agreement. Most of the Conservative leadership candidates have pledged to renegotiate with the EU. Delivering on Brexit was a central goal of the June 2017 confidence and supply agreement between the DUP and Conservative Party; therefore it is likely once a new leader is chosen the backstop and border issue will be one of the first items on the agenda.

Taoiseach responds to resignation

Leo Varadkar has outlined that there is a growing risk of no-deal. The DUP leader urged Varadkar to recognise the flaws in the Withdrawal Agreement; however, Mr. Varadkar remained firm on ROI's position that the backstop is the best mechanism to avoid a hard border on the Island of Ireland. The Irish PM noted that it is important that Britain recognise that two of the three elected MEPs for NI were pro-remain and also support the backstop agreement.

Europe

EU budget 2020

The UK is expected to fully participate in the implementation and financing of the EU 2020 budget as if it were a full Member State. Overall, the European Commission has proposed an EU budget of €168.3 billion for 2020. The budget is designed to optimise funding for existing programmes as well as new initiatives. The key areas for the 2020 budget allocation are the competitive economy, young people, strengthening security and solidarity in the EU and climate change.

Industry watch

02

Introduction

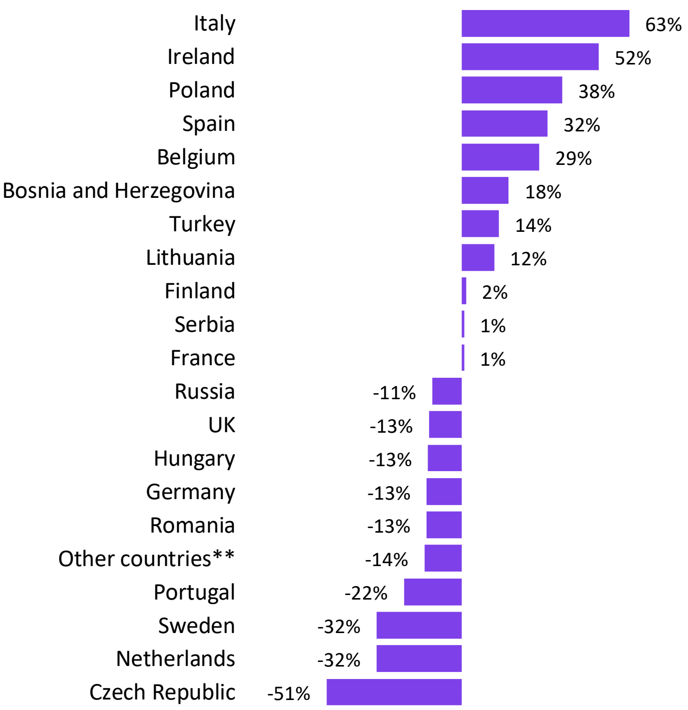
The EY attractiveness survey is a global survey of 506 companies. The survey acts as a key source of insight into FDI around the globe. It examines the attractiveness of a particular region or country as an investment destination for multinationals. The findings of the survey are based on the views of representative panels of international and local opinion leaders and decision makers.

Republic of Ireland's attractiveness

The survey shows that Ireland is currently ranked 10th out of the top 20 European FDI countries. Ireland's market share of FDI increased by 1 percentage point, rising from 2% in 2017 to 3% in 2018 - with the UK, France and Germany capturing the largest market shares at 17%, 16% and 15% respectively. The UK's share of the FDI market decreased from 18% in 2017 to 17% in 2018, however the UK still has the largest market overall.

Ireland saw a marked increase in the amount of FDI projects, jumping to 205 projects (+52%) in 2018. Both the UK and Germany saw significant declines in the number of FDI projects from 2017 to 2018 with the number of projects decreasing by 13% in both countries. The Netherlands registered a substantial decline of 32%. Italy topped the pile in terms of growth of projects reaching 63% albeit they started at a much lower base than Ireland (135 Irish projects versus 63 Italian projects in 2017).

Growth in FDI projects from 2017 to 2018



Source: EY Attractiveness Survey
** Other countries include Switzerland, Denmark, Ukraine, Bulgaria, Austria, Latvia, Slovakia, Croatia, Estonia, Luxembourg, Norway, Belarus, Malta, Azerbaijan, Greece, Georgia, Slovenia, Armenia, Macedonia, Iceland, Cyprus, Liechtenstein, Moldova, Albania, Montenegro and Monaco.

Brexit gives ROI a boost

The surge in FDI into Ireland was driven by growth in investment in the digital, business services and finance sectors, which collectively increased 53% last year. The various Brexit dates are likely to have boosted Ireland's attractiveness as an alternative to the UK. However, when it comes to FDI, Ireland is a hugely attractive country for other reasons: it maintains a competitive and stable corporate tax rate, companies have access to a highly skilled and English speaking workforce, and Ireland has invested significantly in digital and financial skills.

The European story

Appetite to invest in Europe has reached a seven-year low. Businesses completed 6,653 FDI projects in Europe in 2017 and this dropped to 6,356 in 2018 - a 4% decrease. The downturn was caused by a sizeable 13% decrease in FDI in Europe's two largest economies - Germany and the UK - which together account for approximately one-third of FDI in Europe. The economic and political uncertainty prevalent at European and local level has caused businesses to stall or cancel FDI. Our research finds that various forms of political uncertainty are the most significant risk to Europe's attractiveness in the next three years. Surveyed firms say Brexit is the number one risk to Europe's attractiveness, and political instability in the EU is second.

Only 27% of firms plan to establish or expand operations in Europe in 2019 – compared to 35% in 2018. In the short-to-medium term, it is unlikely European attractiveness will drastically change, but currently, only 37% of surveyed businesses foresee an improvement in Europe's attractiveness in the next three years, compared with 50% that did so last year.

Looking to the future...

Political instability in Europe will continue to impact FDI and indigenous business decision making. The current economic and political climate in Europe and across the globe is not the stable environment that enables FDI to expand and flourish.

Additionally, an ageing population, competition from emerging markets, skills shortages, and migration flows are cited as some of the main risks to European attractiveness.

For access to the 2019 European attractiveness survey click here.

Business developments

03

Deja-vu: the cycle repeats

We are now within five months of the revised Brexit deadline. There is a marked inverse relationship between time left and societal and political Brexit-related discourse. This is even more noteworthy than that which prevailed in the lead up to March 31, due to the anti-climactic lull which characterised April.

The prudent observer may look to the tone of such discourse. Positivity (in some quarters) marked Donald Trump's recent visit to the UK, during which he claimed that a 'phenomenal' trade deal – in which the volume of trade could as much as triple – could be brokered between the UK and USA in the wake of Brexit.

However, from a broader perspective, pessimism prevails. We increased our probability estimation of a no-deal to 30%, making it the most likely outcome among the five scenarios considered. This is not an isolated opinion - in a recent Reuter's survey of the current outlook, they found that more than half of the banks canvassed had increased the probability of a no-deal Brexit in recent months. Notably, BNP Paribas doubled its no-deal probability from 20% to 40% since March 2019.

All banks currently put no-deal probability at less than 50%. However, the increase in these likelihoods across the board, coupled with probabilities of up to 40% that a deal will not be brokered, demonstrates more than ever the vital importance of contingency planning to futureproof against such an outcome.

Lessons not learned: a return to the narrative of extremes

Echoing previous issues, an unhelpful narrative of extremes has re-emerged. Following May's resignation, the level of uncertainty surrounding the coming months has greatly increased. Those vying for the role, not least Boris Johnson, have outlined their readiness to accept a no-deal outcome on 31 October should any deal brokered be suboptimal in their opinion.

This type of rhetoric is a red flag for businesses and investors in the UK, as well as raising general anxiety among the public. It shifts focus away from practical, cohesive efforts to ensure firms and individuals are supported and thriving. Independent of the final outcome, this is damaging. Manufacturing export orders have fallen to their lowest point since the Brexit referendum, with the sector forecasted to grow at only 0.2% in 2019 and 0.8% in 2020, according to the manufacturing group Make UK.

Firms must counter this risk environment by executing mitigation strategies, minimising sunk costs and visibly operating a 'business as usual' attitude.

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

Source: EY Estimates

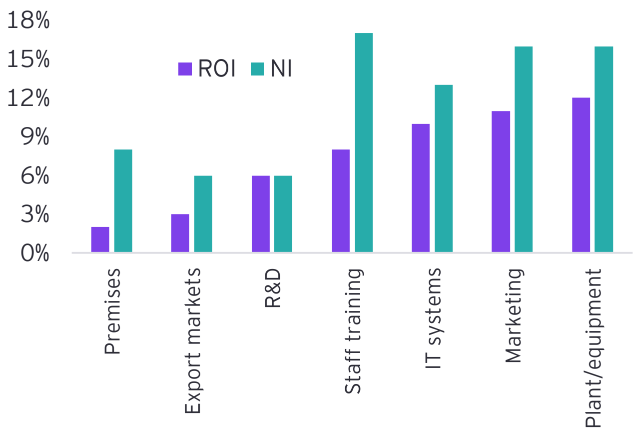
Brexit-induced stagnation deepens

InterTradeIreland's 2019 Q1 Business Monitor illustrates the detrimental effects a volatile operating environment is having on businesses. All categories displayed a decline in investment intentions since Q4 2018. Of particular note is the level of staff training, which has fallen for three consecutive quarters and currently stands at just 11% across the island. This displays the enduring consequences of current political manoeuvrings.

A marked trend emerging this quarter is that of NI firms' optimism. NI firms' investment intentions exceed that of their ROI counterparts in every category apart from R&D, where it is equal. This is demonstrative of a resilient, resourceful attitude, which should be adopted by all businesses.

This also illustrates the potential disconnect between self-reported sentiment measures and hard economic data. The latter should provide reassurance to firms in ROI, which has just reported its highest job numbers on record, rising 3.7% to 2.3 million in the first quarter of 2019.

Over the next 12 months do you have to undertake any of the following investments for your business?



Source: InterTradeIreland

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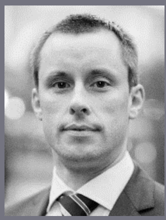

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