Brexit watch

Monthly briefing on Brexit developments

Issue 42 | 11 July 2019

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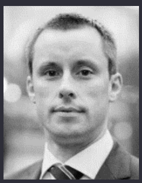

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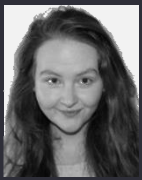

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Brexit uncertainty is beginning to creep into economic indicators. The increased chance of a no-deal outcome is cited as the primary reason for a downturn in some data. Boris Johnson and Jeremy Hunt, the remaining challengers for the Tory leadership, have both outlined their willingness to exit the EU without a deal.

EY now calculate the probability of a no-deal scenario at 40%, an increase of ten percentage points since our last issue.

This is a tumultuous time for EU leaders, as well as the increasing likelihood of a no-deal Brexit, they face a growing backlash over nominations for the top jobs in Europe. Leading EU politicians have been vocal in their stance that they are not open to renegotiating the Withdrawal Agreement and the extension to the leave deadline.

Here, Leo Varadkar has shown some openness to an extension, providing it is for a specific purpose and not for renegotiations or indicative votes. Simon Coveney has also issued a warning for businesses to take the 31 October deadline seriously and not assume any further extension will be granted.

Aside from Brexit, there are other individual challenges for all parties to face. The Financial Times have outlined that the UK is teetering on the brink of recession and Euro Area forecasts have been revised downwards. Northern Ireland, while enjoying a buoyant labour market, is experiencing a downturn in manufacturing indicators. The Republic of Ireland has been warned by the Chief Executive of the National Treasury Management Agency that its debt burden is still too high.

The lead up to the official Brexit date is set to be volatile, especially when viewed in conjunction with geopolitical issues. Businesses and governments alike are encouraged to adopt contingency measures where possible.

EY DKM

Political developments

01

Countown to Brexit

112 days

United Kingdom

Conservative leadership race

160,000 Conservative Party members have been issued with ballots to vote for their next leader – with some members reportedly receiving two ballot papers. The vote closes on 22 July with the new party leader expected to be announced on 23 July. Members that have received two ballots have been warned that voting twice will result in expulsion. An ESRC Party Members Project report found that Brexit is the largest issue for Conservative Party members with 88% citing it as the biggest issue with the economy (45%) and immigration (31%) following behind. Furthermore, 76% of Conservative Party members surveyed would be willing to leave the EU without a deal with most believing that warnings about a no-deal outcome are exaggerated or invented.

Fake deadline fallout

Jeremy Hunt has branded the 31 October Brexit deadline as a fake deadline designed to trip a general election in the UK. Boris Johnson, Hunt's competition in the leadership challenge, has called on Hunt to commit to the Halloween deadline. Johnson has also promised to deliver on the deadline, "come what may", and has outlined that he will get the UK in "match fit" shape for a no-deal Brexit. Possibly alluding to corporation tax rates, Johnson is willing to slash taxes outlining that the UK will be free to substantially diverge from the EU on tax and regulation.

Economic uncertainty hitting UK growth

The Financial Times has reported that the UK is near recession based on the downturn in manufacturing and economic indicators. The Confederation of British Industry (CBI) has also warned that the rising threat of a no-deal Brexit has set the UK on course for the biggest business spending decline since the onset of the financial crisis in 2009. The CBI reports that business spending is expected to decrease by 1.3% in 2019 compared to the previous year. Understandably, Brexit uncertainty is cited as the leading factor. The OECD have revised downward the growth forecasts for two of the UK's largest trading partners (the USA and Eurozone) which may impact demand from the UK.

Ireland (NI & ROI)

ROI to step up no-deal preparations

Tánaiste and Minister for Foreign Affairs, Simon Coveney, has said that the chances of the UK leaving the EU without a deal have never been higher. Mr Coveney warned businesses not to expect the same Brexit outcome as March and April when there was an extension and a disorderly Brexit was avoided. Coveney has said that an updated contingency plan will refine and improve plans already in place.

No-deal effect on NI

The former Conservative attorney general, Dominic Grieve, has said that the Northern Ireland (Executive Formation) Bill is a legitimate mechanism to stop the UK leaving without a deal – something the two Conservative leadership hopefuls have said they are willing to do. Grieve outlined that leaving without a deal could be the end of Northern Ireland's union with the UK. The Bill would delay holding a Stormont assembly election until 21 October with a further extension possible until January 2020.

Northern Ireland Purchasing Managers Index (PMI)

The latest Ulster Bank Northern Ireland PMI® reported a potentially worrying downturn in the NI private sector. Key takeaways from the June report outlined new orders hit a seven year low, export orders fell at the fastest pace in almost eight years, manufacturing output fell at its fastest pace in over ten years, construction activity hit an almost seven year low and NI orders, output and jobs fell faster than any other UK region. The report outlines a turning of the economic cycle in NI with the severity depending largely on what Brexit result is achieved in October. It is important to note that NI employment is at record levels, though sentiment surveys suggest this has changed in recent months.

Europe

EU Council nominations

In a somewhat surprise move, EU leaders have nominated German Defence Minister Ursula von der Leyen to be the next president of the European Commission. Christine Lagarde has been nominated for presidency of the European Central Bank. Most of the new positions will not be occupied by incumbents until 01 November and therefore will unlikely effect the current Brexit process. Nominations are subject to EU Parliamentary approval with the president of the European Commission vote expected to take place on the week of 15 July.

Industry watch

02

Katherine Doyle

Katherine is an intern economist with EY Economic Advisory. She studies Economics and Finance at UCD and has an interest in agriculture, economic policy and the economic implications of Brexit.

Introduction

In this issue we look at the agri-food sector in the Republic of Ireland (ROI). While the ROI economy is set to be impacted by the UK's withdrawal from the EU, the agri-food sector is especially exposed. The sector contributes significantly to the Irish economy, employing 174,000 people across ROI and accounting for 7.8% of Modified Gross National Income (GNI*). Brexit poses potential challenges for the agri-food industry, including the introduction of trade barriers, logistical issues and a reduction in EU funding, whilst the diversification of Irish exports into new markets is crucial.

Brexit

In 2018, €12.1bn worth of food and drink was exported from Ireland with 37% of this (€4.5bn) exported to the UK. If the UK exits the EU without a deal, then tariffs are potentially on the horizon. Michael Gove, British Secretary of State for Environment, Food and Rural Affairs has promised UK farmers, "protections for sensitive sections of agriculture and food production". From an ROI perspective, this translates as tariffs on exports of products such as beef and cheddar cheese, with the price of the former potentially rising by up to 7%. The ROI Department of Agriculture has estimated that such tariffs could cost the entire sector €1.7bn.

Brexit also raises logistical challenges in terms of access to EU markets. Bord Bia recently surveyed agri-food producers in Ireland as part of their Brexit Barometer. 53% of respondents use the UK land bridge to access European markets while 64% of these firms have begun to plan alternative routes to avoid the land bridge in the future. In terms of overall Brexit-readiness, 65% of respondents have made clear progress, which is a significant increase compared to the 2018 figure of 20%.

Source: Bord Bia

Common Agricultural Policy (CAP) Reform

CAP is managed at European level and is funded by the EU budget. The UK is a net contributor of approximately €9bn per annum to the EU common budget. Currently 80.2% (€1.5bn) of EU spending in Ireland goes towards agriculture. Approximately 130,000 Irish farmers receive EU farm subsidies, and according to a Teagasc study, the average total direct payment per farm was €17,292, which on average, accounts for 74% of Family Farm Income (FFI). The European Commission has proposed modernising and simplifying CAP as part of the EU budget 2021 – 2027. The proposal includes attributing 40% of the overall budget to climate action, and allotting at least 2% of direct payment allocations to assisting young farmers to become established. However, the European Commission has also proposed cutting CAP funding by 5% (€17bn), which could mean a fall of 3.9% in direct payments to Irish farmers.

Alternative Markets

African Markets

Michael Creed TD, ROI Minister for Agriculture, Food and the Marine has placed significant emphasis on trade missions during his time in office. ROI has established links with overseas trips to countries such as Turkey, China and Japan. Until late 2018 in order to export to Libya, individual boat-by-boat veterinary health certificates were required. However, following the introduction of agreed health certs, there has been a 446.9% increase in live exports to Libya from ROI. 4,211 cattle were exported from ROI to Libya in the first six months of 2019, compared to 770 in the same period in 2018.

EU Mercosur Agreement

Mercosur is a South American trading bloc whose member states are Argentina, Brazil, Paraguay and Uruguay. In 2018, the EU and Mercosur bloc exchanged €88bn worth of goods. Following almost two decades of negotiations, in June 2019 it was announced that a new trade deal had been agreed upon. The Irish agri-food sector is set to benefit from the removal of tariffs on cheese and other dairy products. However, the deal proposes allowing 99,000 tonnes of South American beef to enter the European market annually. There has been vocal opposition to the proposed agreement. A European Commission report conducted to examine the economic impact of future trade agreements on agriculture, concluded that such a deal with the Mercosur group could result in a drop of up to 16% in beef prices. The ROI government has committed to conducting a full economic review of the deal before casting its vote at the European Council in two years' time.

Business developments

03

No-deal the only legal certainty

The uncertainty and fatigue which businesses have faced in the three years since the Brexit referendum result is undeniable. It is prudent to plan for the worst-case scenario, that the UK will leave the EU without a deal on 31 October. This is indeed the forerunner in the latest EY Brexit outcome probabilities.

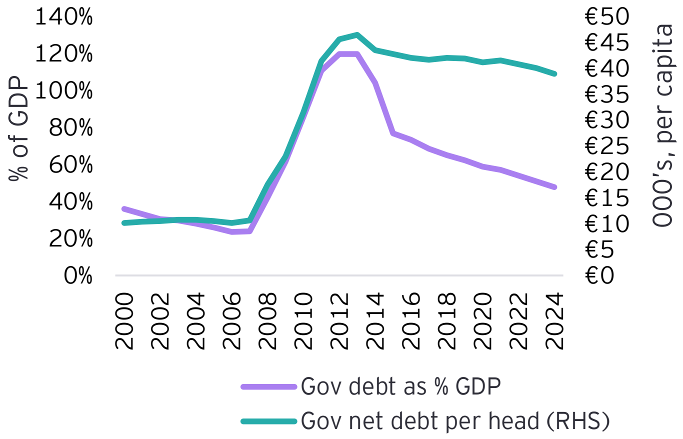
Deal probabilities	Likelihood	Change since last issue
WTO (no-deal)	40%	More likely
FTA	20%	No change
Single market + customs Union	10%	No change
Hybrid arrangement	10%	Less likely
Remain in EU/EEA	20%	No change

Source: EY

Timing is key

The timing of the UK's scheduled exit could signal significantly more disruption than its March predecessor. One such reason is its proximity to Christmas. Household names such as Tesco and Sainsbury's have publicly warned of stock shortages, such as of toys and food, which a no-deal would herald. This would materialise from firms vying for additional warehouse space to stockpile ahead of a no-deal, as well as the Government stockpiling necessities such as medicines. This situation will emerge far in advance of the Brexit deadline, even if a deal is negotiated at the eleventh hour. For this reason, firms must ensure they execute contingency plans ahead of time, whilst seeking to minimise any sunk costs involved.

Government net debt as % of GDP & per capita, 2000-2024, ROI



Source: IMF World Economic Outlook April 2019, EY calculations

Ireland must be cautious of complacency

Achieving record levels of employment and being hailed as the number one relocation destination for banks post-Brexit has increased ROI's international profile and general economic optimism. However, its vulnerability to external conditions such as geopolitical developments must be acknowledged. Furthermore, the scale of the crisis endured barely a decade ago must not be forgotten.

National debt is one area which illustrates the need for ROI to remain alert to its vulnerabilities. This month, Conor O'Kelly – Chief Executive of the National Treasury Management Agency (NTMA) – discussed Ireland's "mountain of debt", pointing out that it remains elevated with much progress still to be made. Furthermore, servicing this debt will cost three times the amount paid in the five years preceding 2008, despite borrowing costs being four times lower. In 2019 this will cost the state €5 billion.

Placing this in the current volatile geopolitical context, it is concerning that 90% of ROI's borrowing is sourced from overseas investors. Compounding this vulnerability is the forecasting that a no-deal Brexit may increase the nation's debt burden by €27bn over four years.

O'Kelly cited investors' belief in the resilience of the Irish economy as the main reason why more consequential effects of geopolitical developments have not materialised. However, market sentiment can change quickly, particularly when coupled with external weaknesses such as the emerging Italian debt crisis and Eurozone growth slumping to a six-year low in 2019.

Despite government debt almost halving from 120% of GDP in 2013 to 65% in 2018 this has had a negligible per capita impact (although inflation will have reduced the purchasing power of €40,000 debt per capita over the last decade). The former measure is artificially lowered by the effects of intellectual property transfers and MNCs based in Ireland.

Ireland can ill-afford to become complacent of the mounting risks. Its success can be attributed in large part to the openness of its economy, but this in turn increases vulnerability to external, global shocks. O'Kelly explained that Ireland must be in permanent contingency mode, due to its heavy debt burden, regardless of the particular crisis. Brexit is only one-such risk, with US-China trade tensions and the Italian debt crisis among others.

Recent figures released from some forecasting houses have also depicted Ireland losing its title as fastest-growing English-speaking nation in the Eurozone. For example, Focus Economics see Malta growing at 5% in 2019, with Ireland behind at 4%. Notably, government finances will prevent significant spending to deal with any downturn, in contrast with a decade ago. Whilst the economy is performing well, firms must remain alert to both the risks and opportunities.

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