Brexit watch

Monthly briefing on Brexit developments

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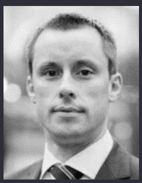

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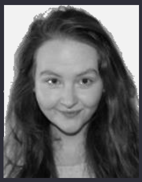

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There are now 57 working days until the official Brexit withdrawal date of 31 October, which leaves very little time for all sides to come to an agreement. We now assess the probability of a no-deal scenario at 40%, which is significant reason for concern.

As we head towards a potential no-deal Brexit, reports indicate that Boris Johnson and his team have no plans to re-open negotiations and are operating under the assumption that the UK will leave the EU without a deal come 31 October. In the media, Johnson has outlined that he will not renegotiate unless the "undemocratic backstop" is removed. This leaves potential negotiations at a stalemate with both ROI and the EU seemingly unyielding on the backstop. However, if the UK leaves the EU without a deal then no backstop will be in place, and a border with some level of checks and controls will be inevitable.

Leo Varadkar appears more hopeful than both his EU and UK counterparts and continues to outline that avoiding a no-deal outcome is possible, despite aligning with the EU's position that the Withdrawal Agreement is not open for renegotiation. Given Johnson's position, avoiding a no-deal Brexit would mean he either accepts the backstop, and potentially loses the support of the DUP, or an as yet unidentified alternative arrangement, assuming the EU is willing to re-open negotiations without the backstop. One thing appears certain - Boris Johnson has committed to removing the UK from the EU at the end of October, with or without a deal.

Just 5.1% of the new £2.1 billion in Brexit supports has been allocated to businesses in the UK. Business leaders in NI have come together to issue a statement warning of the dangers of a no-deal Brexit. The Confederation of British Industry has criticised business planning by the UK Government, advising that it only mitigates issues in the short term, leaving the longer term open to uncertainty. Businesses have weathered much uncertainty over the past three years and are likely to face more.

Political developments

01

Countdown to Brexit

83 days

United Kingdom

Boris wins Conservative leadership race

With 66.4% of the votes cast by party members, Boris Johnson was elected as the new leader of the Conservative Party, replacing Theresa May as British Prime Minister. Since his appointment, Johnson has continued to reiterate his "absolute commitment" to removing the UK from the EU on 31 October. Johnson has pledged to abolish the "undemocratic backstop" and has reshuffled his cabinet - those that refused to sign up to his pledge to leave without a deal resigned from their positions or were sacked. In a further commitment to leaving the EU, the UK will not nominate a UK Commissioner for the new European Commission.

EU stands firm on no new deal

The EU have reiterated that there will be no re-opening of Theresa May's Withdrawal Agreement. Re-affirming their stance that the former Prime Minister's agreement is "the best possible deal". The backstop would see NI retain a very close relationship with the EU for an indefinite period of time. The DUP see this scenario as cutting NI off from the rest of the UK and aligning more with ROI/EU – an outcome seen totally unpalatable by DUP leaders. Johnson will need to continue to support the removal of the backstop if his party is to retain the support of the DUP, which is helping to keep the Conservative Party in government.

Additional £2.1 billion allocated for Brexit

The UK Government has allocated £2.1bn in Brexit related funding. The £2.1bn is additional to the existing £4.2bn which has been allocated since 2016 bringing the total funding to approximately £6.3bn. Of the £2.1bn, £1.1bn is available for immediate use while an additional £1bn has been put aside if needed.

Additional funding breakdown

Allocated to	Amount	Share of new funding (%)
Vital medicines & medicinal products	£434m	20.7%
Border & Customs	£344m	16.4%
Media campaign & consular support	£138m	6.6%
Business supports	£108m	5.1%

Source: BBC

Ireland (NI & ROI)

Varadkar dampens hopes of an end date

The Taoiseach has outlined that talks surrounding Brexit may continue on for a number of years past the 31 October deadline. He outlined that if there is no deal at the end of October, all sides will have to talk. It's not clear however that a willing listener would be found in London. Before a potential free trade agreement is discussed, Mr. Varadkar outlined the top items on the agenda would be citizens' rights, the financial settlement and the Irish border. The financial settlement, valued at £39 billion, has been openly criticised by Johnson in the past.

NI business leaders unite

As a no-deal outcome looks increasingly likely, business leaders in NI have rallied together to voice their concerns over the potential detrimental economic and social impact. 27 bodies, including the Ulster Farmers' Union, Confederation of British Industry (CBI) and the Irish Congress of Trade Unions issued a joint statement calling for Johnson to avoid the negative impacts a no-deal Brexit would inflict on the region. The CBI has previously outlined that neither the UK nor EU are adequately prepared for a no-deal scenario. In InterTradeIreland's latest all-island Business Monitor, fewer than 10% of businesses surveyed felt they were prepared for a no-deal exit, with 34% of micro firms (those with fewer than 10 employees) recording profit margins of less than 5%.

The CBI commended the contingency planning by businesses to date but indicated that planning was hindered by unclear advice, timelines, cost and complexity. The CBI further outlined that while larger firms are better equipped to absorb the costs associated with contingency planning, smaller firms are particularly exposed due to greater constraints. The CBI's "*What comes next?*" report examines no-deal preparations from a business perspective. The report indicates that, to date, many of the UK Government's plans prioritise short-term stability which in turn will feed long-term uncertainty by delaying the negative impacts of Brexit but not removing them.

Europe

No possibility of re-negotiation?

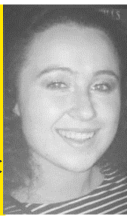
EU diplomats have been told that Boris Johnson has no intention of re-opening the Withdrawal Agreement and that leaving the EU without a deal is his "central scenario". Diplomats were briefed after a meeting between Johnson's chief envoy and senior EU officials that "refusal to compromise was clear to those attending."

Industry watch

02

Clodagh Nash

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



Introduction

Agri-food in NI is a significant element of the economy - accounting for approximately 70,000 local jobs and 3.25% of NI's Gross Value Added. The Ulster Farmers' Union has estimated that for every £1 spent on farming, £7.40 is contributed to the wider local economy. Additionally, the Agri-food & Biosciences Institute have outlined that for every one job in food and drink processing the multiplier effect results in generating almost two jobs elsewhere in the NI economy.

Access to markets

The food and drinks sector, valued at £5 billion, is NI's largest manufacturer and exports to over 70 countries. Outside of the UK market, the NI agri-food sector is heavily reliant on ROI for sales, with 54.9% of total NI agri-food exports outside the UK going to ROI. Including the rest of the UK reduces the ROI export share to 15.6% of the total.

NI Agri-food exports to ROI (£m)

	Value (£m)	% Share
Milk & Milk Products	149.6	22%
Drinks	146.8	21%
Beef & Mutton	98.4	14%
Poultry	94	14%
Bakeries	72.8	11%
Pork	68	10%
Fruit & Vegetables	56.2	8%
Fish	6.5	1%
Total	**692.3**	

Source: NI Assembly

Adding greater uncertainty to the current situation, producers are unsure how they will navigate the land-bridge and the extent of the financial implication of adhering to EU legislation – which they may have to deal with after the UK exit. Under EU law, products of animal origin imported from outside the EU are subject to examination at a border inspection post (BIP), however there are no plans at present for a BIP on the NI/ROI land border.

As an additional concern, the EU has legislation for the protection of food names based upon their geographical origin, particular recipe or uniquely distinctive features. At present, NI has three protected geographical indication (PGI) approved products: Comber early potatoes, Armagh Bramley apples and Lough Neagh Eels. It remains unclear if these goods will be offered the same protection once the UK leaves the EU.

Grant dependency

The UK was a net contributor of an estimated €8.9bn to the EU common budget in 2018. NI farmers receive grants from the common budget in various forms, but most notably under the common agricultural policy (CAP). Currently 58% (€3.7bn) of EU spending in the UK goes towards agriculture. Approximately 25,000 NI farmers received CAP subsidies in 2018 and the average total direct payment per farm was £27,125 - which corresponds to 80% of Farm Business Income (FBI). FBI refers to the return on all unpaid labour and capital invested, measured across all farm types.

According to the Department of Agriculture in NI, total farming income decreased by 23% from £467 million in 2017 to £360 million in 2018. FBI is expected to decrease from £33,870 in 2017/18 to £26,030 in 2018/19, i.e. a decrease of £7,840 or 23% per farm. While there was a marginal decrease (0.6%) in direct subsidies, the decrease in FBI was mainly driven by an increase in higher total costs for feedstuffs. However this is higher than the previous 2016/17 level - FBI increased from £20,206 to £33,870 from 2016/17 to 2018/19.

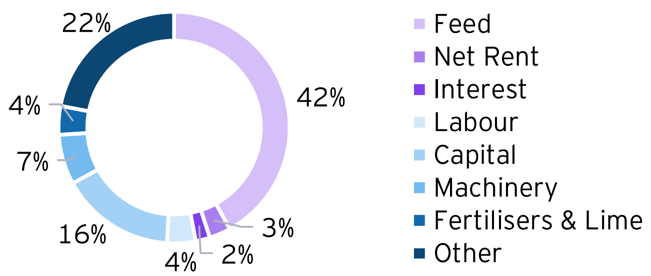
In areas where production conditions are difficult, known as Less Favoured Area (LFA) land, profitability and sustainability are increasingly difficult for farmers. Producers in NI are more reliant on subsidies than their EU counterparts with 70% of NI's land mass falling under the LFA land category compared with 57% of the overall utilised agricultural area in the EU. The former Secretary for the Environment Michael Gove said that the UK Government will only guarantee subsidies at the current EU level until 2022 which increases uncertainty for farmers.

Tariffs & currency

In the event of a no-deal Brexit, the UK Government has outlined plans to cut import taxes on goods crossing from ROI into NI in the short term. This would make NI a backdoor into the UK market for ROI producers. On the other hand, NI producers would likely be priced out of the market as exports into the EU would attract tariffs. On top of this, currency volatility could make UK exports more competitive but also make importing commodities such as agri-foodstuffs, fertiliser and equipment more expensive.

The agri-food industry in NI has shown its resilience in the past, as one of the few industries to have recorded sustained growth during the recession. However, Brexit may bring the sector its greatest challenge yet.

Total NI agricultural expenses 2018



Source: Department of Agriculture, Environment and Rural Affairs

Business developments

03

No-deal an 'ugly' prospect

A no-deal outcome to Brexit negotiations is an ugly prospect. This is true in any economy, but even more so for ROI, which experienced first in class GDP growth in 2018 along with record employment levels. Accompanying all of Westminster's political bustle this month was the expected influx of no-deal commentary and refreshed forecasts.

Comments from Leo Varadkar, who stated that everyone in the UK and Ireland should be 'afraid' of a no-deal will compound the business community's rising anxiety. Businesses should focus time and resources on controlling what they can control by taking practical, well-executed mitigation steps. With our latest Brexit outcome estimates showing a 40% chance of a no-deal, edging ever-closer towards a 50-50 chance, it is the forerunner among the possibilities and must be taken seriously.

EY outcome probabilities

	Likelihood	Change since last issue
WTO (no-deal)	40%	No change
FTA	30%	More likely
Hybrid arrangement/customs union	10%	No change
Single market/Norway +	10%	No change
Remain in EU/EEA	10%	Less likely

Source: EY Ireland Brexit update

Making sense of the latest forecasts

New reports were released by the Irish Government, the Irish Central Bank, the Northern Ireland Civil Service (NICS), the UK's Office for Budget Responsibility (OBR) and the Bank of England August Interest Report. All reports provided a damning indictment of any scenario in which the UK is not an EU-member state, but in particular if no-deal comes to pass.

It is worth examining each jurisdiction's reports in turn. For such an unprecedented scenario, there is a high level of uncertainty regarding the macroeconomic impacts which may ensue given a no-deal exit. It may be frustrating for firms that no consensus on impact has emerged, but the modelling of a no-deal outcome is extremely complex, with many factors to consider, most of which are interdependent. This makes granular analysis difficult and means most estimates are just that – estimates.

ROI has a lot to lose

As the UK's closest economic partner, it follows that ROI has the most to lose from Brexit among its European counterparts. The Central Bank of Ireland estimates that, under a no-deal scenario, by the end of 2020 there will be approximately 34,000 fewer jobs created in ROI compared to the level of employment growth projected in the central forecast, and 110,000 fewer over the next decade. Furthermore, Ireland's Minister for Finance and Public Expenditure and Reform outlined that a no-deal Brexit could potentially lead to 55,000 ROI job losses within two years of the UK leaving the EU. The narrative is similarly bleak regarding growth. The Government forecasts Irish GDP to be circa. 5% lower under a no-deal after 10 years, with 2020 seeing close to 0% growth in this context. The Central Bank sees growth reduced to 0.7% under these circumstances in 2020 (a marked reduction from its 4.1% baseline forecast).

NI in a vulnerable position

Placing a focus on cross-border trade, NICS forecast that EU tariffs coupled with non-tariff customs barriers would reduce NI's exports to ROI by 19%. Leaked UK Government documents take this further, stating that cross-border agriculture trade would 'virtually stop' overnight in a no-deal scenario. Recently, Belfast reached the headlines in a positive way due to the boom in its tech industry, being named the best city in the UK for skilled tech workers outside of London. It is therefore worrying that this report forecasts FDI into the region to decrease by 6% under a no-deal scenario, with FDI-related job creation reducing by 7.6%.

Deal or no-deal, a UK recession could be on the horizon

The Bank of England decided to maintain interest rates at 0.75%. Alluding to the 'damage already done' mantra, they cited a one in three chance of the UK entering recession in 2020 whether a deal is made or not.

The UK Government's independent forecasting body, the OBR, released its analysis of the medium to long-term outlook for public finances and fiscal sustainability. It projected the UK economy to contract by circa. 4% by 2021 under a no-deal. The Bank of England also cut its growth projections for the UK, regardless of the Brexit outcome, to 1.3% in both 2019 and 2020, down from 1.5% and 1.6%, respectively.

Concerning the labour market, the OBR has projected unemployment to rise above 5% (a substantial increase from its current 3.8%, meaning an extra 445,000 people out of work). Given that falling productivity is already a competitiveness issue for the UK, it is a stark forecast that labour productivity will decline by 2.2% by 2021 in a no-deal. Consumer confidence will also be damaged by the anticipated 10% decline in house prices by mid-2021.

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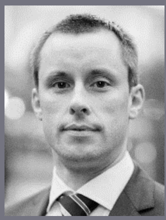

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