EY DKM

Issue 33 | 27th September 2018

Brexit watch

Monthly briefing on Brexit developments

In this issue

- Salzburg summit fallout
- Brexit and goods trade between ROI and the UK
- Business developments and EY's current Brexit outlook

For all parties involved in the Brexit negotiations returning to office after summer recess proved to be more fruitless than desired.

The EU Salzburg summit brought tensions between the EU and UK to the forefront of media coverage. Theresa May's proposals were resoundingly rejected by her fellow EU leaders. The EU's actions prompted May to publically demand respect from the EU. The possibility of a further deterioration of relations cannot be discounted given the tone of recent exchanges. The March exit date is approaching fast (originally November was cited as the final date for putting contingency plans in place). Clearly there is much work to be done in the weeks ahead, perhaps not surprising given the high stakes and divergence of starting positions.

There is substantial work to be done in the time for the next summit. However, given where we currently are, this is looking more and more unlikely, although some politicians do remain hopeful.

An extra Brexit summit has reportedly been agreed for November. Given the lack of actual tangible progress during the most recent summit it is likely to be a busy period for officials and negotiators. Rejections and rebuttals can only occupy discourse for so long at Brexit summits, eventually tangible progress will have to be made or else a no-deal may become a reality. With both sides currently refusing to budge, and the Irish border being one of the most contentious issues, compromise will be required. Negotiations will be tense and public statements can only reveal so much, it is impossible to know what progress may or may not being made in the background. With officials and advisors in each of the member states well aware of the stakes, there may well be a more hopeful undercurrent of progress that the TV cameras cannot observe.

Given recent developments, EY's Brexit Strategy Team have increased the likelihood of a no-deal scenario (WTO rules) by 5 percentage points over the last two months, going from 25 per cent in July to 30 per cent in September.

Seán Golden
Economist | EY-DKM
Economic Advisory

Sarah McDowell
Economist | EY-DKM
Economic Advisory

1 Political Developments

United Kingdom

Second Brexit referendum

The EU summit in Austria saw the British Prime Minister's Brexit plans unanimously rejected by EU leaders. Both the EU and the UK committed their desire to having reached a deal before the special Brexit summit in November. However, the British Labour Party's Brexit spokesperson, Keir Starmer, outlined that nobody is ruling out remain and that if the Prime Minister returned with a deal that did not meet their tests, Labour would vote against it.

May challenges Europe

Theresa May has challenged the EU to provide an alternative proposal after her plans were rejected by EU leaders in Salzburg last week. May outlined that the talks were currently at an impasse and outlined this was due to two main issues. She also made the point that she would not break up her country, perhaps alluding to the issues surround the Irish border and backstop. The Irish border remains the chief stumbling block of negotiations with both sides refusing to change their position. Chris Grayling, the UK Transport Secretary, added that what the EU are currently asking for in regards to Northern Ireland is impossible for any British Government to accept and if the EU remains resolute on the subject there will be no-deal. Speaking in absolutes, as the Transport Secretary has done, reflects the red lines that still remain as obstacles in the negotiations.

Summit Watch

Below are important event dates in regards to Brexit:
(Dates subject to change)

- 17th - 18th of October, EU summit
- 17th - 18th November, EU summit
- 13th - 14th December, EU summit

British cabinet agrees stance on immigration

The UK cabinet has agreed its post-Brexit immigration policy for potential immigrants from EU countries. The cabinet will support a system based off skill rather than nationality with EU immigrants to face the same rules as those from elsewhere.

Ireland (NI & ROI)

Bilateral meeting 'useful'

Both Leo Varadkar and Theresa May described their bilateral meeting as 'useful'. While not surprising, Mr Varadkar outlined that the EU are standing behind ROI and any agreement that does not work for ROI does not work for the EU. The ROI Taoiseach outlined that while he was willing to budge on some issues, having a legally enforceable guarantee that no hard border would be introduced in Ireland is an absolute requirement.

DUP veto potential

The Minster for Foreign Affairs and Trade, Simon Coveney, has warned that no one party in NI can be allowed to wield a veto in relation to a deal on the Irish border. The comment from Mr Coveney comes off the back of the British Prime Minister's disclosure that she was considering tabling such an option to the DUP. Mr Coveney's comments are understandable, the lack of an Executive in NI and no nationalist representation at Westminster adds greatly to the complexity of the situation.

Irish Labour party leader questions May's ability

Brendan Howlin is worried that the current negotiation trajectory will not yield any positive results between now and the next EU summit. Mr Howlin also questioned negotiation abilities that will carry with both the House of Commons and the Conservative Party. The Labour leader added further urgency to Brexit negotiations outlining that a settlement needed to be reached within the next three weeks.

Europe

Tusk calls for compromise from both sides of the table

The European Council President, Donald Tusk, stated that the very nature of negotiations requires compromise from all parties. Even after the unanimous rejection of Theresa May's Brexit proposal at Salzburg Mr Tusk remains optimistic a deal can be reached. However, Tusk said that any deal or compromise reached will not undermine the single market and the freedoms of the EU.

2 Economic Developments

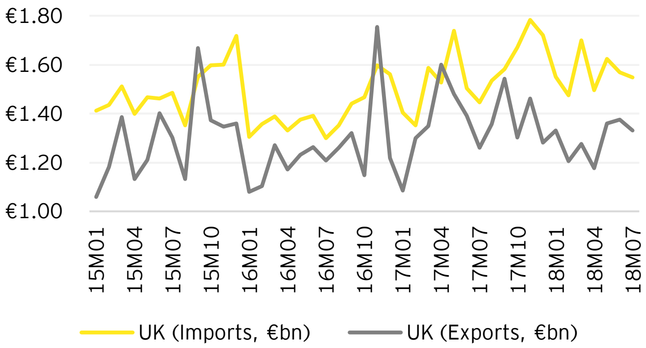
Brexit and Trade; a Goods Overview

Trade between ROI and the UK represents the integration and mutual reliance of both economies. The implication of Brexit on trade represents one of the biggest risks following the UKs decision to leave the EU. Trade between both economies is split between goods and services. Goods imported from the UK to ROI at €1.5bn in July 2018 represent a large share (20.4 per cent) of the overall value of global imports to ROI. Goods exported to the UK represented 12.1 per cent (€1.3bn) of the value of overall goods exports.

Goods and Services History

ROI has had a trade deficit with the UK, in terms of value of goods, in 40 of the last 43 months. The data outlines ROI is more reliant on the UK for imports, at the aggregate level, than vice versa.

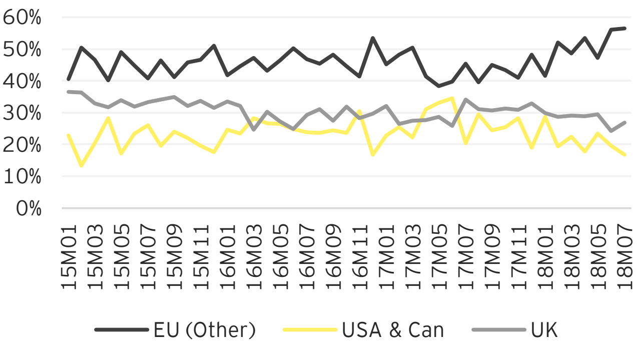
Fig 1: ROI exports/imports of goods to/from the UK



Source: CSO

While ROI may appear, from the above graph, to be more reliant on the UK for value of imports, this is a trend that has been decreasing since 2015. Analysing data from the EU (not including UK), USA and Canada and the UK, ROI imported 37 per cent of its value from the UK. This has decreased by 10 percentage points to 27 per cent in July 2018 while the EU increased from 41 per cent to 56 per cent.

Fig 2: Percentage share of value of goods imports



Source: CSO

Composition of Imports & Exports

Table 1 and 2 show the composition of the top 5 imports and exports categories between ROI and the UK by euro value. They outline the importance and the nature of the trade relationship between both economies

Table 1: ROI Top 5 Imports from UK (€m)

	2015	2016	2017	*2018 H1*
Petroleum, products and related materials	1,927	1,342	1,948	*964*
Gas, natural and manufactured	1,149	701	784	*479*
Miscellaneous manufactured articles	1,115	991	1,020	*458*
Unclassified estimates	712	945	960	*444*
Medicinal & pharmaceutical products	654	651	1,093	*458*

Source: CSO. Top 5 refers to highest value accumulated from 2015 to 2018 H1

Ireland imports a significant amount of energy products from the UK. This may suggest that a no-deal Brexit could significantly affect energy prices in ROI. However, this depends on how much is produced in the UK rather than just passing through. While the value of Ireland's exports to the UK is heavily contingent on pharmaceutical and agri-business with the latter subject to the most severe tariff rates in the event of a no deal.

Table 2: ROI Top 5 Exports to UK (€m)

	2015	2016	2017	*2018 H1*
Medicinal & pharmaceutical products	1,526	2,045	3,227	*1,184*
Meat & meat preparations	1,903	1,845	1,930	*974*
Dairy products & birds eggs	771	698	835	*427*
Organic chemicals	1,030	696	567	*292*
Essential oils, perfume materials, toilet preparations etc.	772	708	712	*345*

Source: CSO, Top 5 refers to highest value accumulated from 2015 to 2018 H1

The future of goods trade

There is significant value in goods traded between both ROI and the UK. This is represented by the value of the goods and also the economic spill over effects within both economies e.g. jobs. It is imperative going forward that indigenous ROI business are protected from price volatility that may come with introducing tariffs. The same can be said for businesses based in the UK. Price elasticity and sensitivity is a key economic indicator which would show the effect a price change would have on consumers purchasing goods. Of course, changes in price would depend on what trade deal the UK reaches with the EU and other countries that it had a previous agreement with under its EU membership.

For businesses involved heavily in trade between ROI and the UK it is important to monitor this situation closely and continue to contingency plan for potential outcomes.

3 Business Developments

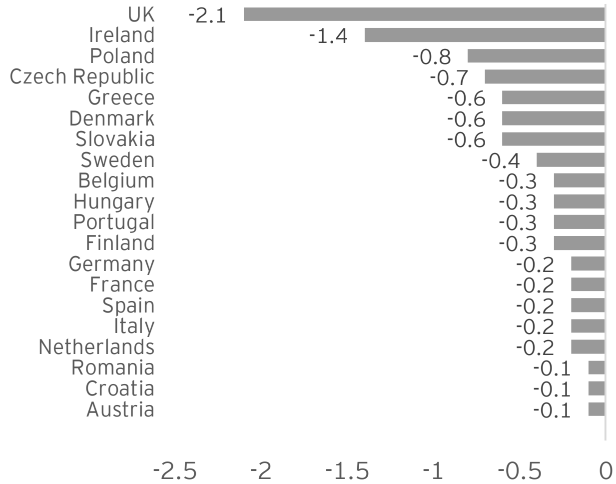
Paschal Donohoe addresses the NI Chamber of Commerce

Last week saw ROI's Minister for Finance visit Belfast. He addressed delegates from the business community on Brexit and its impact on the Island of Ireland. He highlighted the central importance of maintaining the 'free-flowing and frictionless' border, which has enabled interconnected supply chains and distribution networks. With 73 per cent of NI's SMEs relying on ROI as their primary export market, it will provide comfort that Minister Donohoe reaffirmed the ROI Government's commitment to ensuring that a hard border has no place in post-Brexit Ireland. This, he said, would benefit not only Ireland but the UK and EU as a whole.

International discourse hones in on wider impact

As the March 2019 exit date approaches, the realisation that the UK's economic performance impacts that of Europe is setting in. Oxford Economics has projected that, following a no-deal exit, the UK's GDP would be 2% lower than its baseline forecast. Crucially, this fall would be sufficient enough to push the labour market into contraction, something that would be very materially felt by the public. So too would other nations suffer who trade closely with the UK, as shown in figure 3. Given the dependence of the Irish economy on multinationals (who employ over 210,000 people in ROI) the wider international macroeconomic environment should also be at the forefront of discourse. Forecasts have however performed relatively poorly to date in predicting impact and so the level of scepticism has increased when reacting to estimates of potential loss.

Figure 3: Impact of no-deal on GDP of European Nations: % difference by Q4 2020 relative to baseline forecast



EY Brexit Strategy Team: Current outlook

Following a tumultuous month of political manoeuvring, the EY Brexit Strategy Team's probability of a no-deal scenario has increased. Whilst this is unsurprising, it is worth noting that this no-deal likelihood has been at this level before (November '17). Businesses should remain calm and continue to plan for all eventualities including - but not limited to - that of a no-deal.

Table 3: Current Brexit Outlook

	% likelihood (September 2018)	More or less likely since July 18?	More or less likely since referendum?
Free Trade Agreement	30	**Same**	Less
Customs Union	30	**Less**	More
World Trade Organisation rules	30	**More**	More
European Economic Area	5	**Same**	Same
Remain in EU	5	**Same**	Same

A positive consequence of the no-deal psyche is that emphasis is being placed on practical preparations. September's Technical Notices received much less coverage than August's, due to more immediate concerns like the Budget occupying front pages, but were no less important. These proposals can only represent the UK's approach to a post-Brexit landscape; for example, the UK Government will grant exemptions to scheduled maritime services from EU ports to the UK, but UK ships travelling to EU ports will have to provide information including the last 10 ports of call, cargo and passenger lists. This will provide some assurance to Irish businesses trading with the UK. Firms are advised to review the papers and determine which, if any, have direct implications for their own operations.

EY Capital Agenda Blog

EY's UK Profit Warning Index provides insight into the sectoral spread of risk. Some industries are fairing worse than others; the retail profit warnings hit a seven year high in the first half of 2018, as automation continues to threaten footfall. In addition to actual profit warnings, the metrics on what searches are carried out provides insight into perceptions and the expectation of sectoral difficulties. For example, construction commanded 17% of searches but only 5% of actual warnings in Q2 2018. In a low margin industry which is particularly vulnerable to price rises of inputs and overheads, this reflects increasing concerns regarding Brexit and geo-political volatility.

EY | Assurance | Tax | Transactions | Advisory

ey.com

www.ey.com/ie/economicsforbusiness

@EY_Ireland

Follow us

Contact us

Professor Neil Gibson
Chief Economist | EY-DKM Economic Advisory
neil.gibson1@uk.ey.com
+44 28 9044 1700

Seán Golden
Economist | EY-DKM Economic Advisory
sean.golden@ie.ey.com
+ 353 1 221 1567

Sarah McDowell
Economist | EY-DKM Economic Advisory
sarah.mcdowell@uk.ey.com
+44 28 9044 1930