

Brexit watch

Fortnightly briefing on Brexit developments

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In the past week UK officials provided a number of clarifications on the future relationship with the EU. Some came from Prime Minister May's speech last week - her third to explicitly focus on her Government's post-Brexit preferences. More came with the UK's reaction to the EU Commissions' draft Withdrawal Agreement. The draft aims to put the agreements - agreed as part of phase one of negotiations - into legal format. While it is yet to be debated amongst Commission members, the UK made their disapproval clearly known. Arguably, these rebuttals give negotiators greater insight into the British Government's thinking before phase two negotiations begin - something EU officials have been asking for over the past few months.

The DUP was particularly unimpressed with the text and Mrs May has aligned herself quite strongly with these views. That being said, there have not yet been any viable counter-proposals on how both physical infrastructure and continued membership of the Customs Union could be avoided.

While speeches and drafts made public positions clear, unofficial reactions and leaked documents added another dimension to the commentary. In particular, the European Council's draft negotiating guidelines, which were released to the press on Wednesday. The phrasing suggests the EU are uninterested in accommodating any UK demands that are not similarly as beneficial to the union, and makes a point of denouncing 'cherry picking'. Of notable interest, is the absence of any discussion on financial services, or a related deal.

Whilst only five pages in length, the draft is still the most specific outline of a future relationship from the EU to date. The proposals within the draft stand in direct contrast with the Prime Minister's speech, in which she calls for hybrid arrangements. The key idea is a trade agreement with zero tariffs or quotas which would likely allow the EU to enjoy a trade surplus, given current trading patterns.

European Council President Donald Tusk offered his thoughts on the issue at a press conference in Luxembourg. He said - 'I fully understand and respect Theresa May's political objectives to demonstrate at any price that [Brexit](#) will be a success and was the right choice. I'm sorry, this is not our objective ... No member state is free to pick only those sectors of the single market it likes, nor to accept the role of the ECJ only when it suits their interest. By the same token, a pick-and-mix approach for a non-member state is out of the question.'



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1 Political developments

Ireland

Taoiseach rebuts May's suggestion that negotiations are a three way discussion

Following Theresa May's speech last week, Taoiseach Leo Varadkar has moved to align himself closely with the EU, denying that Ireland would negotiate as a separate party. When discussing phase two talks, the Prime Minister explained that 'the Taoiseach and I agreed... that our teams and the Commission should [work together]', implying to some that three parties would be coming to the table.

Mr Varadkar vehemently spoke against this explaining that 'what will happen is there will be talks between the EU 27 and the UK. Ireland is part of the EU 27 and we're much stronger as one of 27.' Ireland is naturally exposed, and in a more sensitive position than any of its EU counterparts, so it is unlikely the Irish Government will allow any impression that it will negotiate independent of the EU.

However, to the rest of the speech, the Taoiseach gave 'a guarded welcome'. Mrs May emphasised protecting the Good Friday Agreement which has been welcomed in Ireland, particularly following the comments of some MPs that the agreement is no longer fit-for-purpose.

Oireachtas members were ambivalent towards the speech. Fianna Fáil's Brexit Spokesperson, Stephen Donnelly, found the Prime Minister's comments 'ignored completely' the solutions the EU laid out for the Irish border and Northern Ireland. In contrast, Chairperson of the Seanad Committee on Brexit, Neale Richmond found it to be 'a step in the right direction' and 'warm' in tone.

Technological border solutions shot down by Irish officials

European Parliament commissioned research: 'Smart Border 2.0: Avoiding a hard Border on the island of Ireland for Customs control and the free movement of persons' was mentioned by pro-Brexit MP, Kate Hoey during Prime Minister's questions this week. The report, which was undertaken independently, used the US-Canada, and Norway-Sweden borders as case studies for the role technology can play in reducing customs friction.

The Taoiseach said the appropriate technologies 'don't exist and have already been dismissed.' He also rejected that the border could be based on the US-Canadian counterpart as there is extensive physical infrastructure and policing involved, after Mrs May highlighted it as part of the examination of specifically as one of the options being explored. This drew much criticism at home with Irish officials pointing out the level of regulation, and therefore physical checks, involved.

Economic Performance

European Union

Available from EuroStat

- Q4 2017 GDP up by 0.6% in both the euro area and the EU28. A year-on-year growth rate of 2.6% and 2.7% respectively was also observed
- Seasonally adjusted industrial producer prices are up by 0.4% in both the euro area and EU 28 from December 2017 to January 2018. Ireland was the only member state to measure a decrease (-0.4%)

Great Britain

Available from the ONS

- Consumer Price Inflation 12 month rate (including housing costs) remained steady at 2.7% in January 2018
- The total UK trade deficit grew by £3.8bn to £10.8bn in the three months to December 2017. This was largely due to a increase in the trade deficit of goods as opposed to services. Large fuel imports played a substantial role here

Recent Statistics

Republic of Ireland

Available from the CSO

- Average weekly earnings for Q4 2017 €734.60 - a 2.5% increase on Q4 2016. An increase was observed in 10 of the 13 sectors measured with strongest growth (5.0%) in the *Information and Communications* sector. This sector also had the highest weekly average at €1,100.79
- The Live Register for February 2018 stands at 234,900 - a month-on-month decrease of 3,400 and year-on-year decrease of 39,749

Northern Ireland

Available from the NISRA

- Seasonally adjusted unemployment rate for NI from October to December 2017 was 3.9%, the joint lowest figure since 2008
- The economic inactivity rate (28.4%) decreased over the same period by 0.5 percentage points and increased by 2.3 percentage points over the year
- The volume of construction activity increased by 1.2% from Q2 to Q3 2017. The year-on-year increase was 11.3%

1 Political developments

European Union

Draft Withdrawal Agreement met with 'anger' in the UK

The European Commission released a [draft](#) Withdrawal Agreement last week, which aims to legalise the language in the Joint Agreement that facilitated completion of phase one negotiations. It also works to set out in detail that which was only referred to broadly in the Joint Agreement. The Agreement focuses on EU citizens' rights, the divorce bill, and the Irish border.

On the border, the text outlined that both parties would ensure no physical checks or infrastructure would be established between North and South. Pertinent to Ireland, the draft outlines the *default* option should a 'no-deal' scenario arise, Northern Ireland would remain in the customs union. As could be expected, many members of the UK Government took great issue with this protocol:

'[The EU and UK] desires to create a common regulatory area on the island of Ireland in order to safeguard North South cooperation, the all-island economy, and protect the 1998 Agreement.'

The draft expands on this idea and would require full alignment between the North and South, but not necessarily between Northern Ireland and the rest of the UK. Downing Street [confirmed](#) that Theresa May, who is [reported](#) to have responded 'with anger', will not agree to 'anything that threatens the constitutional integrity of the UK.'

EU trade negotiation guidelines do little to address May's requirements

The EU's vision of the future trade relationship somewhat dismisses Theresa May's red line issues, but aims for a mutually beneficial free trade agreement. The European Council draft [document](#) released on Wednesday, restates the EU's 'determination to have as close as possible a partnership with the UK in the future' but brands the UK's expectations as 'limiting'.

The four freedoms are described as 'indivisible' and cannot be 'cherry picked' - a nod to criticism of Mrs May who has outlined demands that typically require EU membership. Following the same tone, the draft guidelines require the UK to bring about a level playing field post-Brexit. As it will no longer have to follow state aid, regulatory or tax rules, the Council makes a point of asking for 'substantive rules aligned with EU and international standards.'

The document has yet to go through revisions with the 27 remaining member states.

United Kingdom

Theresa May uses speech to provide more clarity, but still finds herself being asked for more

Theresa May gave her third [speech](#) on the future economic partnership with the EU last week, following the release of the draft Withdrawal Agreement. Content on border infrastructure was in line with that of the EU recommendations but she added - 'we chose to leave; we have a responsibility to help find a solution.'

As expected, there was deviation on the default scenario. The Prime Minister firmly stated a regulatory border would not be created down the Irish Sea as 'it would also be unacceptable to break up the United Kingdom's own common market'.

Beyond these comments, little was added on how the UK would like to see the issues addressed.

Philip Hammond flags majors concerns in airline industry

The clock is ticking for the airline industry which needs confirmation on the transition before 1st April. Chancellor Philip Hammond [echoed](#) cries of the industry when speaking at a parliamentary committee this week.

As airlines typically put seats for sale one year prior to departure, and with Brexit now just over a year away companies are desperately asking whether a transition agreement will be resolved before such flight scheduling can be released to the public.

Talks between the US and UK on a post-Brexit open skies agreement have stalled, further complicating matters. The FT first [reported](#) on secret talks held in January where US officials forwarded an agreement that was undeniably worse than the UK's current situation, as part of the EU. Ownership is proving to be the sticking point, with substantial ownership needed to lie within the US or UK for an airline to benefit.

Northern Ireland

Barnier meets Sinn Féin and the DUP

Michel Barnier met separately with both Sinn Féin and the DUP this week in Brussels. The EU's chief Brexit negotiator sat down for the first time with the two main parties in Northern Ireland, as final preparations for trade are carried out. Sinn Féin leader Mary-Lou McDonald [referenced](#) the experience as a 'meeting of the minds' and said it now falls on Theresa May to address the party's concerns, as shared with Mr Barnier. Arlene Foster of the DUP similarly [felt](#) her discussions were part of 'constructive meeting', however she also recommended the EU show a greater flexibility than has been demonstrated thus far.

2 Economic Updates

Trends in the Retail Sector, as trade talks are set to begin

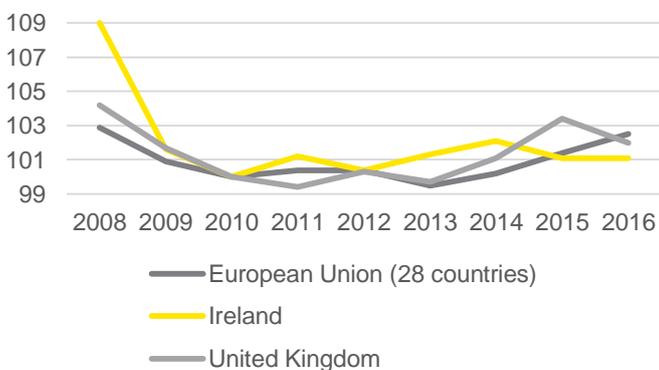
As mentioned in the previous section, the EU is keen to secure a free trade agreement with the UK, however the first point in the [draft](#) negotiation guidelines reiterated that 'nothing is agreed until everything is agreed.' There is doubtless a vast number of sectors that will be impacted by whatever deal is reached (or not). In this issue we look at the retail sector, and if Brexit has had any impacts as of yet.

Import prices of goods and services for retail sale - and the raw materials for such goods and services - impact competitiveness and the price that is passed on to the consumer. In theory, any tariffs will have a negative effect on prices, as the goods and services traded for retail today are not subject to any additional trade costs. Moving forward, a UK firm's dependency on materials from the EU (and vice versa) could impact risk - in a sector that is already facing threats to its business model. Retail business models have worked to adapt to the threat of online retail, however increased tariffs are unlikely to provide any relief.

Sector Analysis: Trends during the recovery

As can be seen from figure 1 below, growth in retail trade (turnover) has been subdued since 2010. Ireland is below the EU average in index growth, not seeing much of a recovery on 2010 figures. The UK saw quick growth (relative to the EU and Ireland) from 2013 to 2015, but fell again from 2015 to 2016.

Figure 1: Retail Trade Index, Base = 2010



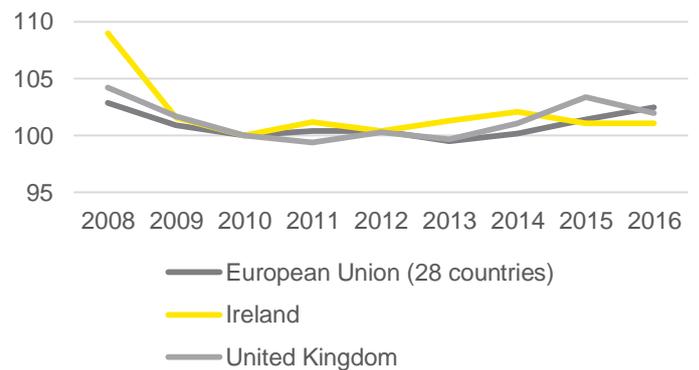
Source: Eurostat

Note: Index of deflated turnover, retail trade excl. motor vehicles and motorcycles, seasonally adjusted data

Figure 2 below looks at employment as an index with 2010 again as the base year. In a very similar way to figure 1 we observe a fall in the index in the UK from 2015 to 2016, with Ireland remaining below the EU average.

In the case of figures 1 and 2, the EU average is emerging above both the UK and Ireland indices in 2016 for the first time. This measures as a 1.1% employment increase in 2016 versus 2015, as seen in figure 3. Ireland measured a 0.0% year-on-year change in employment, however in the UK, this percentage figure stood at -1.3% the greatest percentage point drop measured since 2010 across the three areas in question.

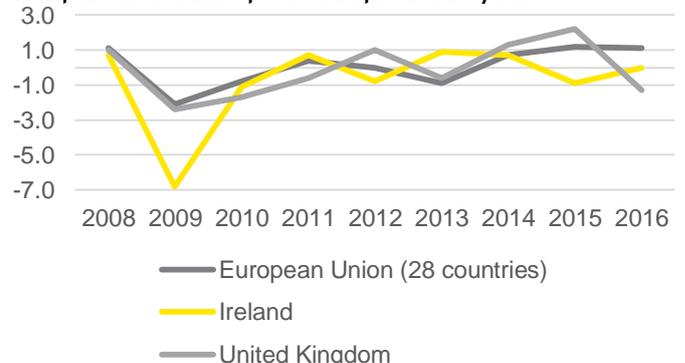
Figure 2: Employment in Retail Index, Base = 2010



Source: Eurostat

Note: Employment retail trade excl. motor vehicles and motorcycles, unadjusted data

Figure 3: Employment in retail - percentage change compared to same period in previous year



Source: Eurostat

Note: Employment, retail trade excl. motor vehicles and motorcycles, unadjusted data

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