Brexit Watch

Fortnightly briefing on Brexit developments

Issue 18, 11th January 2018

In this issue:

- ***Reshuffle does little to reignite the Tories***
- ***EU budget planning looks to fill Brexit shaped hole***
- ***End of year indicators show strong Irish growth***

Today sees the launch of our 18th Brexit watch, our bi-weekly summary of Brexit news. This is our first as EY-DKM Economic Advisory and we look forward to continuing to bringing this to you every fortnight alongside our other economic advisory offerings. See our new website for more information on the new team and please get in touch if you want to know more.

Commentary:

The first fortnight of January has seen the UK Government reorganise themselves in an effort to move seamlessly through the second phase of Brexit negotiations which needs to be wrapped up by October of this year so that concerned parties can legislate accordingly. Media consensus is that Prime Minister May has allowed another opportunity to reignite confidence in her leadership fall by the wayside, following a less-than-ideal cabinet reshuffle. As she prepares for Phase Two of negotiations, she will surely want as much momentum behind, and unity within, the government as possible.

The EU has moved towards directly communicating with UK companies, in an effort to prepare industry for the 'regulatory chill' coming with Brexit. Reports have surfaced this week of legal notices sent by the EU over the past two months. One prominent example is the airline industry where UK operating licences will be obsolete within the remaining EU 27, post March 2019. The move has irked UK Brexit Secretary David Davis who subsequently aired his complaints to the Prime Minister. It seems with eleven days into 2018, there's little to suggest the year ahead will be much different than the previous one with respect to political relationships and viewpoints.

Political Developments

United Kingdom

Cabinet reshuffle not the fresh start Conservatives were hoping for

Following three senior level resignations from cabinet at the end of last year, adjustments to Theresa May's cabinet were inevitable. Tricky as they are, reshuffles present Prime Ministers with an opportunity to adjust any nagging issues, and for Mrs May particularly, the chance to re-establish her authority as the Conservative leader. It had been speculated this was on the cards since the snap election, last June. However, given the bad judgement which Mrs May accepted blame for, a reshuffle was seemingly too risky to the weakened Premiere at the time. The New Year was not to prove optimal either, with commentary ranging from 'chaotic' and 'botched' at worst to merely 'underwhelming' and 'modest' at best.

The Telegraph first reported on plans of introducing a no-deal Minister to cabinet as a means of appeasing hard-Brexit Tories. The position was debated across the media only for Mrs May to relent on the idea at the eleventh hour. The move is said to have 'dumbfounded' Eurosceptic members of the government. Meanwhile, the most senior ministers including Brexit Secretary, David Davis, were left in their respective positions. Labour leader, Jeremy Corbyn, criticised the reorganisation and renaming of government departments as a 'pointless and lacklustre PR exercise' and that '[you] can't make up for nearly eight years of failure [referring to the NHS] by changing the name of a department.' A number of gaffs including incorrect personnel announcements on social media, and general execution struggles gave many the impression of an unpolished government who this year will try to negotiate a new trade relationship with the EU.

David Davis criticises the EU for preparing a no-deal scenario

Following the leaking of a letter from Brexit Secretary David Davis to Prime Minister May, seen by the FT, it has become apparent that Mr Davis is unhappy with EU plans to prepare for a no-deal scenario. Mr Davis suggested in said letter that the move by the EU to prepare for such an outcome could threaten contracts in the UK, or push businesses to relocate pre-emptively. His concerns have been met by harsh criticism from home and abroad. Opposition politicians have highlighted what they believe to be hypocrisy on the Minister's part with Labour MP Pat McFadden noting that as 'the government is implicitly threatening a no-deal scenario, it should come as no surprise that the EU is also preparing for this scenario.' In response to reports, the European Commission's chief spokesperson, Margaritis Schinas, said 'here in the European Commission we are somehow surprised that the UK is surprised that we are preparing for a scenario announced by the UK government itself.' The Chancellor apportioned £3 billion towards UK preparations for a no-deal scenario, in the most recent budget last November.

Northern Ireland

New Secretary of State for Northern Ireland

As part of the aforementioned reshuffle process, a new Secretary of State for Northern Ireland was chosen in Karen Bradley. Unlike some of the other moves, the former Arts and Culture Secretary gained her place as a result of her predecessor, James Brokenshire resigning due to health complications. Ms Bradley will hope to restart power sharing talks between Sinn Féin and the DUP following the government breakdown a year ago. Of interest to the Republic is the Secretary's commitment to avoiding a hard border, post-Brexit. Speaking after her appointment she said 'We must also continue the work to deliver a Brexit that recognises Northern Ireland's unique circumstances and avoids a hard border on the island of Ireland while maintaining the economic and constitutional integrity of the United Kingdom.'

Ireland

Government seeks to protect farms as EU Budgetary process begins

As discussions begin on the next EU multiannual financial framework (MFF), Taoiseach, Leo Varadkar, and Finance Minister, Paschal Donohoe, have said they will be examining how EU remuneration to farmers and businesses at home can be best protected. Following Britain's departure, the gap in the EU budget is estimated to be between €12 billion and €13 billion annually. Mr Donohoe has identified two key issues for Ireland in light of Britain's exit, and the subsequent decline in available funding going forward. 'There are a number of different options in relation to the budget. We clearly have particular needs in relation to European funding, in relation to how we support the Common Agriculture Policy and in relation to how we support research and development in our country,' the Minister explained.

European Union

EU begins planning MFF

President of the European Commission Jean-Claude Junker has outlined plans to increase EU expenditure, which will require further contributions from each member state. This comes as all finance ministers in the remaining EU 27 met to discuss the next period of spending. In line with his call for member states to step up and effectively fill the gap, Mr Junker cautioned against anyone assuming the UK will be contributing financially in any form after March 2019. 'My working hypothesis is that the British are going to be leaving us on 30 March 2019. So between now and then, we need to do our utmost to find the means to react to the loss of a significant number of billions of euros,' he said. The Commission has proposed making up the €13 billion approx. per annum by collecting 50 per cent of it in the form of new contributions, and saving the other 50 per cent through spending decreases.

EU Budget

The Planning Process

As mentioned in the political updates, the EU is beginning to discuss the next MFF which will, as of now, cover budgets over the seven year period of 2021 to 2028. Given the number of member states involved, and the challenge posed by losing a significant contributor, the timeline for planning is understandable.

Ireland will seek to impress upon its counterparts the importance of farming protections, particularly as the industry will be vaulnerable to a sharp contraction if a trade deal is not achieved. In the event of a no-deal Brexit, products like dairy and beef could see tariffs of up to 60 per cent, as is set by the World Trade Organisation.

The Budget and Brexit

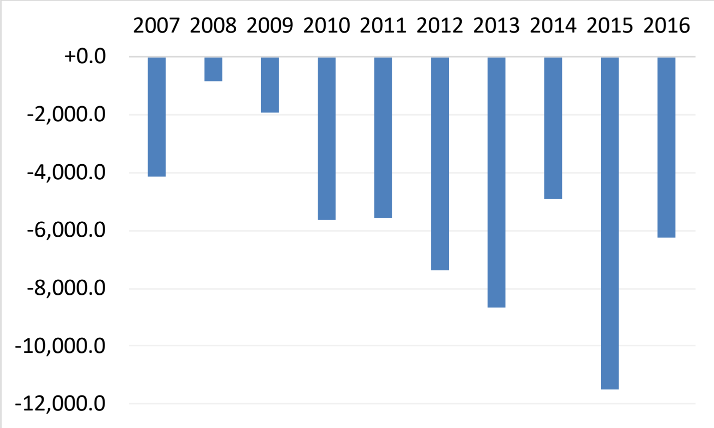
An image we have all become familiar with since the Brexit referendum is the now infamous red bus of the Vote Leave campaign. Known for conveying the message 'We send the EU £350 million a week, let's fund our NHS instead', the bus hit at a nerve regarding the EU budget. In 2016, the UK contributed a gross sum of £19 billion (€22.2 billion[1]). The UK is entitled to a rebate before transferring the sum to the EU which in 2016 was £5 billion, according to the Office for National Statistics (ONS). A total of £4.4 billion (€5.1 billion) was paid back in EU funded public sector credits which leaves a net contribution of £9.4 billion (€11 billion). This works out to be 1.2 per cent of 2016 government spending in the UK.

The ONS compares its figures with the the EU calculations, which accounts for some credits to the private sector when establishing the net contribution. The EU finds the sum to be £8.1 billion (€9.5 billion) in 2016 which would be 1.0 per cent government spending that same year. This highlights the face that the UK believes it's net contribution is a higher figure than determined by the European Commission.

The Operating Budgetary Balance

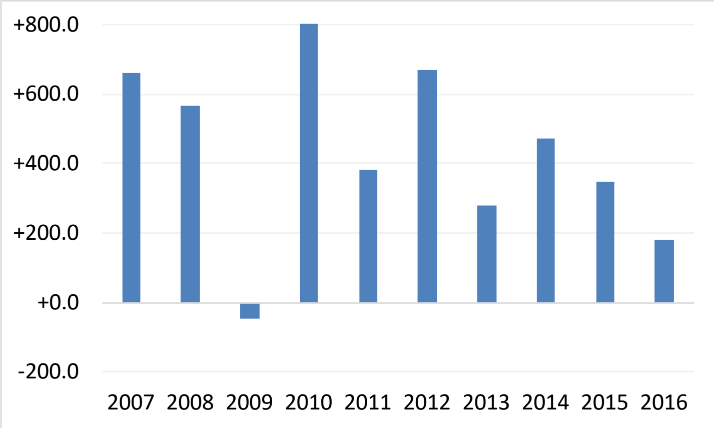
Following on from this, how EU contributions differ in their impact in a particular member state is the operating budgetary balance (OBB). This is the difference between what a country receives from the EU, and what it contributes to the budget. In 2016, 10 of the EU 28 had negative OBBs, with the UK having the third most negative OBB at -€6.3 billion[2], behind Germany and France respectively. Ireland, by comparison, had a positive OBB of €181.4 million. The most positive was Poland with a figure of €7.0 billion. Figures 1 and 2 below show the OBB for both the UK and Ireland over time. As can be clearly seen, there is a stark difference in values, whereby the UK has historically had a negative OBB and Ireland has shown the opposite trend of having a positive OBB in all years but one of the last decade.

Figure 1: Operating Budgetary Balance for UK, 2007 to 2016, in Euro Millions



Source: European Commission

Figure 2: Operating Budgetary Balance for Ireland, 2007 to 2016, in Euro Millions



Source: European Commission

Ireland is showing a decreasing trend in the last three years particularly, however there has been a positive figure since 2010. The fact that the UK reached a low of -€11.5 billion as an OBB in 2015 could be argued as an attributing factor to the Leave Campaign view of financial imbalance between the EU and UK. It is clear that of the loss of the UK contribution to the EU budget will clearly have an impact on Ireland's finances if we are called upon to increase our contribution.

Issues to Consider in Planning the Next Budget

Beyond the financial gap now left by the UK, the EU must also be cognisant of other member states that have seen highly negative OBBs over the past number of years. It is still yet to be decided if the multiannual financial framework will cover five or seven years going forward. The budget structure may also be revamped in the process with the Commission suggesting that the MFF should include a role for all Eurozone governments in the event of economic shocks.

[1] Using Lloyds Conversion Rate from Revenue eBrief No. 11/17.

[2] Source: European Commission Expenditure and Revenue.

Economy Watch

Relocation and Business News

EY Ireland buys out DKM Economic Consultants

In very exciting news for this firm, EY Ireland has acquired DKM to form EY-DKM Economic Advisory Services. This is the first acquisition for EY Ireland and will see the combined entity, EY-DKM Economic Advisory, provide a full suite of economic services in the Irish market. The firm will provide support to both public and private sector clients, helping them to understand the current and future environments they operate in, thereby allowing improved decision-making. More information is available at our new website here.

Businesses in Northern Ireland recognise exposure to Brexit shocks in new survey results

Ulster University Business School has received responses from more than 230 companies on the island of Ireland (8 per cent in the Republic) to their Brexit Business Survey. The results indicate a lack of confidence in the future economy, with 64 per cent of respondents believing their business will suffer going forward, as a direct result of Brexit. 94 per cent identified themselves as being at risk. One of the most prominent reasons cited for uncertainty in business in Northern Ireland is the current political climate, where a government has not sat for almost a year.

Ibec Quarterly Economic Outlook shows strong growth across most all indicators

The Irish Business & Employers Confederation (Ibec) has released its Quarterly Economic Outlook for Q4 2017 and has highlighted the strong position of the Irish economy at year end. Over the past number of years public finances have become increasingly healthy, with a close-to balanced budget set for the coming year, and investment forecasted to increase by 10.7 per cent (annual percentage change). Ibec predicts that 2018 will see 4.2 per cent GDP growth on 2017, and that the labour market will reach near full employment. Ireland is also analysed comparatively, and displays the highest growth in real earnings relative to its EU counterparts. As with most forecasts released at present, the estimations going forward are caveated by the uncertainty surrounding Brexit. While the success of completing phase one of the negotiations has greatly reduced the possibility of a no-deal outcome, there is a clear message for businesses: 'uncertainty is here to stay.' However, given Ireland's position as the most exposed EU country to a Brexit shock (excluding the UK itself) it is positive to see good growth in tax receipts, consumption and employment at present. However, there are risks surrounding the sustainability of corporation tax receipts, given the renewed focus on tax policy by the US administration.

Agri-food industry hits exporting records in spite of Brexit

Following the positive news from Ibec, Bord Bia has released new figures for last year confirming the Irish agri-food industry has achieved eight successive years of export growth. The industry achieved a record level of trade at €12.6 billion in 2017, with butter exports increasing by 60 per cent.