Brexit watch

Fortnightly briefing on Brexit developments

In this issue

- **Taoiseach looks for certainty from UK Government**
- **Leaked analysis further splits the Conservative Party**
- **Markets dip over the week**
- **Bank of England discusses inflation and interest rate hikes**

Strong leadership is an influential factor in certain key Brexit variables. Former Brexit Minister, Lord Bridges, reminded his Prime Minister this week that 'to govern is to choose', and without decisive action, Theresa May cannot expect to hold support, or tenability in her premiership. That is not to suggest that the choice facing Mrs May can be made hastily, or be based on a gut instinct. However, with time pressing, little doubt remains on either side of the debate that progress will be slow while a clear path is not set out, or the Government's preferences clearly identified.

The leak of Whitehall's economic analysis indicated that a hard-Brexit, outside of the customs union, will not yield growth in most industries or regions investigated. Notably the leaks have not yet contained the underlying models or assumptions underpinning the analysis making it difficult to assess the robustness. In response to that analysis, Leading Brexiter and backbench Tory MP, Jacob Rees-Mogg, accused the Treasury of 'fiddling the figures', and believes the institution is trying to sway Mrs May towards remaining in the customs union.

Without an indication of the direction the Prime Minister will take, both sides have ample opportunity to voice their concerns.

Whispers that soft-Brexit trade briefings were delivered to number 10 have also heightened tensions within the Government, and specifically within the cabinet. May appeared unwilling to rule out the option of remaining in the customs union when questioned on a recent trip to China. In response to the confusion around the potential trade strategy however, a spokesperson for the Prime Minister sharply contradicted those reports. On Monday, Downing Street said the UK will seek a 'customs partnership' with the EU, in which case tariffs will still be applied. Though the actual agreement would determine the tariff levels and to which product they would apply. Individual firm's exposure therefore remains unclear.

The Prime Minister is well aware that her leadership hinges on the support of her party. After placating the concerns of her colleagues by securing a phase one deal, Mrs May is once again managing a threat to her premiership from within her own, fractious Government.

Commentary continues to focus on Prime Minister May's position as leader but what is arguably more critical to consider is what impact a change of leadership would have and, crucially, when in the process it might occur. All eyes remain on Downing Street where the cabinet met this week, to forge an internal agreement on the trade deal they will seek from the EU.

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1 Political developments

Ireland

Taoiseach looks for certainty from UK Government

Taoiseach Leo Varadkar has called for clarification on the British Government's intentions with respect to membership of the customs union. The request comes as a consequence of Downing Street's ambiguity, particularly over the past fortnight.

Responding to contradictory reports, the Taoiseach said on Monday that he is 'not entirely clear what exactly is being sought' and expects further clarity in the same way as phase one.

Mr Varadkar highlighted the 'very specific commitments' to the Irish border and regulatory alignment determined in December as an example of what is needed as a next phase of talks begin. As the terms of the transition phase are discussed, the Taoiseach is keen to protect Irish business and allow enough time for those affected at home 'to adapt to any permanent changes.' He would not address questions of the need for a general election in the UK, perhaps given the insecurity of Mrs May's leadership.

EU acknowledges the importance of Irish concerns

The FT reported this week that the Irish border issue is viewed in the EU as having the severity to halt talks. A senior EU diplomat commented 'if [negotiations] blow up over the next two months, it will be over Ireland.' The deal struck in December has yet to be put in legal form, which will require a comprehensive definition of 'full regulatory alignment'. British officials are said to be frustrated with the focus on legal minutia, as opposed to high level trade issues. This is unlikely to change however, until further clarification is provided.

Tánaiste speaks at Chatham House and clarifies the Government's position on 'Irexit'

Tánaiste and Minister for Foreign Affairs, Simon Coveney, was conscious of treading the line between fostering relations with the UK, and remaining firm on Ireland's position on Brexit negotiations when speaking at Chatham House last week. Mr Coveney encouraged Britain to seek an ambitious yet reasonable trade deal with the EU and acknowledged the unique role Ireland will play in the next phase of negotiations as a communicator between both parties.

Not to leave Irish interests unaddressed, the Tánaiste tempered discussion of an Irexit, as proposed by Nigel Farage in Dublin this month. In highlighting the relationships the Irish have established in the EU, Mr Coveney noted; 'some commentators here have asked why – 'having joined together in 1973, we shouldn't leave together in 2019' – as if the intervening 45 years of membership were of no consequence.'

The Tánaiste also met with British Foreign Secretary, Boris Johnson and Chancellor Philip Hammond, whose contrasting views will be tested as talks proceed over the coming weeks.

UK Brexit Minister seeks to protect Single Electricity Market

Protection of the Single Electricity Market (SEM) between Northern Ireland and the Republic was highlighted as concern for one British MP. Brexit Minister Robin Walker acknowledged the 'unique arrangement' of the SEM while speaking at the British Irish Chamber of Commerce seminar on future energy relations. In attempting to placate the concerns of interested parties, the MP confirmed the Government hopes to '[facilitate] the continuation of the single electricity market' and made clear it will be a priority in ongoing talks.

Economic Performance

Recent Statistics

European Union

Available from EuroStat

- Euro Area seasonally adjusted unemployment was 8.7%, with the EU28 at 7.3% in Dec 2017. EuroStat measured Ireland's rate as 6.2% in the same month. From Dec 2016 to 2017 the trend has fallen across all member states bar Finland, which remained steady.
- The Flash Estimate for Jan 2018 estimates annual inflation in the euro area has fallen from 1.4% in Dec 2017, to 1.3% in the following month.

Great Britain

Available from the ONS

- The Index of Services: 3 month on 3 month shows that in the three months to Nov 2017, services output increased by 0.4% when compared with the three months to Aug 2017. Average weekly earnings (including bonuses) in nominal terms increased by 2.5% year-on-year.
- CPIH annual inflation rate fell to 2.7% in December, down from 2.8% in November.

Republic of Ireland

Available from the CSO

- Aircraft leasing assets in 2007 equalled €33.5bn, and in 2016 stood at €141.6bn. Employment in the sector rose from 396 to 1,482 with remuneration increasing from €41m to €245m over the same period.
- The seasonally adjusted live register decreased by 3,000 in January to 238,400, the lowest recorded figure since August 2008.

Northern Ireland

Available from the NISRA

- The Labour Force Survey was released for Q3 2017 and shows a 10 year low of 3.8% unemployment.
- The Northern Ireland Composite Economic Index shows year-on-year growth in economic activity of 1.2% from Q3 2016 to Q3 2017.
- 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

United Kingdom

Leaked analysis further splits the UK Government

Contrasting opinions within the British Government have been emphasised in response to controversial Whitehall documents and Theresa May's silence. Leaked economic analysis reportedly outlined that Britain will be worse off, in the medium to long-term in all potential outcomes for the UK leaving the EU. The news bolstered MPs who are in favour of remain. However, a number of civil servants have come under fire from pro-leave politicians who believe efforts have been made to promote a pro-remain narrative. The research suggested that if the UK left with a free trade agreement, growth would be 5 per cent lower than if Brexit hadn't occurred, over the following 15 years. Should the UK leave without a trade deal, growth is estimated to be 8 per cent lower over the same period.

Brexit Minister Steve Baker questioned the value of the leaked documents, describing them as 'not yet anywhere near being approved' and requiring 'significant further work'. Cabinet secretary Sir Jeremy Heywood is accused by government sources of strategically timing the release of the papers to influence ministers to take a softer course of action.

New details from the analysis emerged on Wednesday and estimated that the loss to public finances, as a result of a no deal scenario, would reach £80 billion. This would be in comparison with a continuation of the current status quo, with Britain in the EU.

The North-East of England was identified as one of the regions most exposed to shock and could experience a 16 per cent decrease in regional economic growth.

Scottish group fails to secure Brexit vote for MPs

A Scottish court has thrown out a case brought by seven politicians, asking for the ECJ to rule on whether the UK can abandon Brexit. Pro EU politicians from the Scottish National Party, Scottish Greens, Labour and the Liberal Democrats hoped to receive a ruling which allowed MPs to vote against Brexit, not simply the final Brexit bill. The judge described the case, which was taken against the UK Government, as 'hypothetical and academic.' Debate continues about whether a decision to withdraw article 50 has to be ratified by all 27 EU member states.

In a separate case, British citizens living in other EU countries were successful in convincing a court in Amsterdam to refer a case to the ECJ. They are asking to retain their European rights and citizenship post Brexit.

European Union

Barnier meets Davis and May in Downing Street

Chief Brexit negotiator for the EU, Michel Barnier, reiterated the need to stay in the customs union if trade barriers are to be avoided. Speaking after meeting the Prime Minister and David Davis in Downing Street, Mr Barnier addressed the topic of the week.

'The time has come to make a choice' he explained, echoing Lord Bridges criticism of Mrs May. Brussels has held firm on its position over future trade relationship, and is also seeking further clarification on the UK's expectations of a post-Brexit relationship.

The EU negotiator identified three areas requiring progress before October, namely; translating the joint report into legal text, organising the transition period, and determining the future relationship.

On Tuesday, the European Parliament voted to end barriers to cross-border online shopping for member states, in an effort to make trade within the EU seamless.

European Central Bank (ECB) President advises banks to prepare no transition period

Mario Draghi also responded to current doubt by urging public and private banks to prepare for a Brexit scenario without a transition phase. Speaking to the European Parliament on Monday, the ECB President stressed that 'well managed preparations are thus essential' given the political questions that still remain.

The ECB continues to cooperate closely with the Bank of England as the institutions work to address banking regulation going forward.

Northern Ireland

Gerry Adams calls for special status for NI

The outgoing Sinn Féin leader has branded Brexit a 'disaster' for North Ireland and called for special status to allow the country to remain in the single market and the customs union. Sinn Féin is very much in favour of this option, given the majority pro-remain vote in Northern Ireland. Any outcome other than full regulatory alignment is incompatible with the party's goal of achieving increased cooperation across the island. While their overarching aim remains the same since, over time the means of achieving it have changed. Previously, Sinn Féin was less supportive of EU growth, having campaigned against the Lisbon Treaty in 2008 and 2009. The unique circumstances of Brexit have encouraged the party to move closer to the Irish Government's pro-European stance.

2 Economic Updates

Markets dip over the weekend, BoE discusses inflation and interest rate hikes

Though not directly linked to Brexit, a nonetheless significant aspect of the economy captured the headlines this week.

Following a sharp drop beginning last Friday, the Dow Jones closed down a further 4.6 per cent on Monday and markets in Asia, Europe and the UK followed suit.

The FTSE 100 closed down 1.3 per cent on Monday but by Tuesday markets appeared to be regulating themselves again.

Strong wage growth has been identified as a catalyst of the recent fall causing investor concern over inflation and faster interest rate hikes. Compounding this is the fact that the European Central Bank (ECB) and Bank of England (BoE) will likely pare back their quantitative easing (QE) programmes should their respective economies continue to show GDP growth.

Arguably stock markets have attracted a disproportionate amount of global investment during an era of extremely low returns on government debt. The signal that the world's major economies are returning to more normal interest rate conditions is likely to alter the relative attractiveness of stocks and shares.

Interestingly this comes at a time when global economic data is very positive and, all other things being equal, this should reflect positively on companies. A quirk of economics in 2018 is that an acceptance of a strong global economy can reflect negatively on the valuations of the companies that have driven that strengthening of growth.

The combination of these factors could mean that easy access to cheap money is no longer a given.

What is QE/the APP?

The management of inflation is one of the key objectives of central banking policy. Most of these institutions, including the BoE and ECB, aim for an annual inflation rate of 2 per cent or just below. In situations of low inflation, central banks can lower the interest rate, or the price of money, in an effort to increase borrowing. QE policy is used to stimulate the economy, and is implemented to boost demand in an economy where interest rates are already low. The QE programme in the EU is called the Asset Purchase Programme (APP).

What is the theory behind the policy?

1. Central banks purchase bonds from banks
2. The increased demand also raises the price and creates money in the banking system
3. It is then hoped that a variety of interest rates fall
4. Money becomes cheaper, therefore businesses and households have easier access to finance
5. In turn, aggregate demand, consumption and investment increases

This form of monetary policy is often described as 'unconventional' owing to the nature of it being a last resort. While it can appear an economically sound solution, it is unwise to presume QE is without risk.

Why is it relevant in the context of Brexit?

With Brexit approaching, the BoE will be concerned with the relatively high UK inflation rate, and will work to reduce it to meet the 2 per cent per annum benchmark. The most recent figures available show a 2.7 per cent annual inflation rate for December 2017.

In contrast with the EU, the BoE will likely avoid further expansionary monetary policies until the trend in inflation begins to fall. While the stocks from the term funding scheme have increased steadily month-on-month since February 2016, the stock of gilts and corporate bonds from the corporate bond purchase scheme has not increased markedly over the same period.

Under its APP, the ECB purchased €30 billion worth of government bonds in January, marking the first month with a reduced pace.

This pace is expected to remain constant to September 2018. From March 2017 to December 2017 the APP monthly pace was €60 billion, however the APP began in March 2015, also with a rate of €60 billion monthly, and was briefly raised to €80 billion from April 2016 to March 2017.

In his most recent address to the European Parliament, ECB President Mario Draghi acknowledged the less than satisfactory inflation rate, but also the promising growth that has allowed QE policy to be scaled back this year.

BoE sounds hawkish in latest

On Thursday, the BoE announced that an interest rate hike could occur as early as May with the Monetary Policy Committee acknowledging a rate hike would likely be required 'somewhat earlier' than previously thought in November. On neither occasion has a specific time line been provided. BoE Governor also said 'it's possible that inflation could rise back above 3 per cent, temporarily, in the short term.'

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