Brexit watch

Fortnightly briefing on Brexit developments

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The British cabinet was put under increased pressure this week when the EU confirmed that talks would not continue through the summer if sufficient progress on the backstop agreement was not made in time for the June summit.

To add to Theresa May's difficulties, Boris Johnson publically called the Prime Minister's proposals for a future relationship 'crazy', and Conservative MP Nicky Morgan formed a cross-party campaign against a hard-Brexit.

Satisfying her own party appears to be an increasingly complex situation. The fact that it is playing out in public, with constant press coverage, will only threaten to weaken the British negotiating position with the EU. It highlights the possibility that, if complex dynamics were to remain behind closed doors, such voting 'rebellion' might not have played out so dramatically in the House of Lords over the past month.

On the issue of the upper chamber, Labour party leader Jeremy Corbyn is also faced with a dilemma after 83 Labour peers voted against the party whip, in favour of remaining in the single market. As a consequence, Mr Corbyn will have to decide whether to instruct Labour MPs to vote against the amendments, and therefore with pro-Brexit Conservatives, or in favour and change the party line.

EU Chief Negotiator Michel Barnier has also informed the UK directly that their current proposals for the Irish border are unrealistic. He is reported to have told a meeting of EU officials that it is not worth debating or commenting on the proposals as a result.

At the same time, UK Brexit Secretary David Davis has announced the Government will be releasing a white paper on Brexit which will be the 'most significant publication on the EU since the referendum' and highly detailed. Reports surfaced that Mr David had told the Prime Minister her plan for a customs partnership would be illegal under international law. The Brexit war cabinet met last week but did not reach a consensus on what post-Brexit trade deal to seek in negotiations.

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1 Political developments

Ireland

EU continues to support the Irish Government's stance

The EU has added further weight to the Irish position by confirming that talks will not continue if the UK does not make significant progress on the backstop agreement by June. This was confirmed to Minister of Foreign Affairs Simon Coveney, who met with EU Chief Negotiator Michel Barnier in Brussels this week.

There is a suggestion that Ireland could be pressured to compromise on its red line issues if the EU cannot make progress on the UK's backstop stance by the beginning of the summer.

Coveney speaks to the flexibility of Ireland in negotiations

Mr Coveney spoke on the Irish Government's flexibility on The Andrew Marr Show last Sunday. While Ireland is viewed by some British politicians as obstinate, the Tánaiste said it has actually shown great flexibility in supporting negotiations when strong reservations were held in December.

Politicians, including Coveney, have been accused of consciously using Brexit negotiations to achieve a united Ireland. In response to the interview, DUP MP Sammy Wilson branded the Tánaiste of being 'belligerent, interfering and Brit bashing.' Mr Wilson also suggested that a technological solution is viable but that Mr Coveney's 'republican ardour' was preventing this.

A spokesperson for the Tánaiste responded that none of his comments were a 'threat to unionism' and that the Government respected the fact that Northern Ireland will leave the EU with the rest of the UK in March 2019.

Government more open to Customs Partnership model

Ireland and the EU have shown a renewed interest in discussing the customs partnership model suggested by Theresa May. The proposal was originally described as 'magical thinking' in Brussels, however there is a willingness to revisit it if it 'provides the basis' for productive future talks. This has been interpreted as a softening of the Irish and EU position.

Taoiseach Leo Varadkar explained the move this week - 'The view of the EU is that it isn't workable in its current form but it is something that perhaps we could make workable.'

While EU negotiators may be open to discussions on this front, the Prime Minister still has yet to sell the proposal at home to Conservative and DUP MPs.

Economic Performance

Recent Statistics

European Union

Available from EuroStat

- Industrial Production increased by 0.5% in the Euro Area m-o-m to March 2018. There was an increase of 0.4% across the EU28 over the same period
- Euro area annual inflation was 1.2% in Apr 2018, down from 1.3% in Mar 2018. These figures are for actual HICP
- GDP grew by 0.4% in the Euro Area and EU28 in Q1 2018. The y-o-y change was 2.5% and 2.4% respectively

Great Britain

Available from the ONS

- The Consumer Price Index including owner occupiers' housing costs (CPIH) 12-month inflation rate was 2.3% in Mar 2018, down from 2.5% in Feb 2018
- UK productivity for Q1 2018 decreased by 0.5% on Q4 2017
- The unemployment rate fell to 4.2% in Q1 2018, down form 4.6% a year previous
- Average weekly earning increased by 2.9% in Q1 compared with a year previous

Republic of Ireland

Available from the CSO

- Irish prices, as measured by the Consumer Price Index, fell by 0.4% y-o-y to Apr 2018. There was also a m-o-m fall of 0.2%
- The m-o-m change in the Industrial Production Index was -7.3% to March 2018. The y-o-y change was -9.9%
- In terms of the Industrial Turnover Index, the respective changes over the same time periods are -9.1% and -6.6% respectively
- Exports fell m-o-m by €1.6bn to €10.3bn in Feb 2018. Imports fell by €0.08bn to €6.4bn over the same time period

Northern Ireland

Available from NISRA

- The Labour Force Survey for Q1 2018 showed the unemployment rate to be 3.1%. - a decrease of 0.8pp over the quarter and the lowest figure on record
- The employment rate increased to 69.7% and the inactivity rate decreased to 28.0%
- The Northern Ireland Composite Economic Index results estimate economic activity increased by 0.4% in real terms from Q3 2017 to Q4 2017

1 Political developments

United Kingdom

'You can trust me to deliver' - Theresa May's latest message to the UK

The Prime Minister made efforts to reassure constituents in The Sunday Times. 'I will not let you down' is the key message, at a time when her Cabinet has yet to agree upon what future relationship to seek during negotiations.

The article definitively stated the UK would be leaving the single market to gain full control of immigration and outlined Mrs May's three tests for the outcome she believes the UK wants to see. The first it to fully maintain the integrity of the Union while honouring the Good Friday Agreement. Secondly, establish agreements that minimise trade friction. Finally, leaving the customs union so that the UK has full control to negotiate trade deals with third countries.

She also asked for the public's 'help and support to deliver the Brexit people voted for.' Former UKIP leader Nigel Farage took to Twitter to suggest 'Theresa May is hinting at another election', however May's spokesman said the piece simply explains her commitment to delivering Brexit.

Cross-party launches campaign for soft Brexit

The Prime Minister seems to have set a trend for Sunday editorials, with a trio of cross party politicians writing in The Mail on Sunday that 'hard Brexit demands are holding this country's negotiating position to ransom.'

Conservative MP Nicky Morgan, former Labour Foreign Secretary David Miliband and former Lib Dem leader Nick Clegg officially began their campaign on Monday to minimise the likelihood of a hard Brexit and called on members of all parties to 'reject completely the siren calls to sever the UK's deep economic ties with the European Union.'

House of Lords rebellions put pressure on Corbyn to pick a side

Separately, David Miliband called on Labour Leader Jeremy Corbyn to evolve his position so that the UK remains fully in the single market. Labour does not support remaining in the single market, but rather vows to establish a 'strong single market relationship that hardwires the benefits.'

Mr Corbyn suffered a political defeat when the House of Lords voted to support membership of the European Economic Area (EEA) and therefore the single market. Labour peers were instructed to vote against the motion, however 83 individuals (44% of Labour's numbers) went against this.

The amended Bill will return to the House of Commons where soft-Brexit MPs from all parties will vote on the new clauses. Mr Corbyn will have to decide whether to instruct Labour to vote with pro-Brexit Conservatives, or, against the current Labour party line and support a single market agenda.

European Union

Norway signals a new position on the UK joining the EEA

While still contentious in the Houses of Parliament, Norway has become open to the UK joining the EEA – under which arrangement the UK will be outside the EU but still in the single market. This is known as the 'Norway option'.

The Norwegian Prime Minister, told the FT that the option is 'on the shelf' in spite of warnings that the UK's presence in the group will move focus away from agriculture and fishing. EEA members are currently Norway, Iceland and Liechtenstein.

Northern Ireland

SDLP advise Labour to change their position

In line with David Miliband's calls, the SDLP has written to its British counterpart, the Labour Party, warning that leaving the single market will result in a hard border with the Republic. Jeremy Corbyn believes that staying in the single market would not honour the referendum result – as it is too close to remaining in the EU. At the same time, he wants to avoid any border infrastructure between the North and South of Ireland, which has posed significant customs challenges.

A majority in Northern Ireland voted to remain in the EU at the time of the referendum. SDLP spokeswoman, Claire Hanna wrote 'it cannot be right for the majority opinion here to essentially go unheard' and asked that Labour acts to protect peace in the North and not for 'British political convenience.'

2 Economic Updates

Business Updates

Forex trading activity to move from London to Dublin

Thomson Reuters announced this week that forex trading will move from London to Dublin in light of Brexit. The company's $300 billion-a-day foreign exchange derivatives trade makes it the largest forex business in Europe. The Central Bank of Ireland has received an application from Thomson Reuters to bring its business here however its spot trading activity will remain in London because this type of trading operates outside of MiFID II – the EU's market regulations.

Unlike other moves to Dublin by banking institutions, including Bank of America Merrill Lynch, Thomson Reutrs will not be relocating employees to its Dublin operations. It has however announced it will begin with 20 new positions in Ireland.

Irish subsidiary to be established for Aspen Insurance Holdings

Aspen Insurance Holdings has also announced plans to establish an Irish subsidiary, to continue servicing the EEA market once the UK leaves the EU. The insurer has similarly applied to the Central Bank for authorisation to operate in Ireland.

It is expected that the new unit will open by March 2019 – just in time for the Brexit deadline. The office will start with 12 staff members and the Chief Executive of Aspen Insurance UK said that 'Dublin is a logical fit…given its highly-regarded business and regulatory environment.'

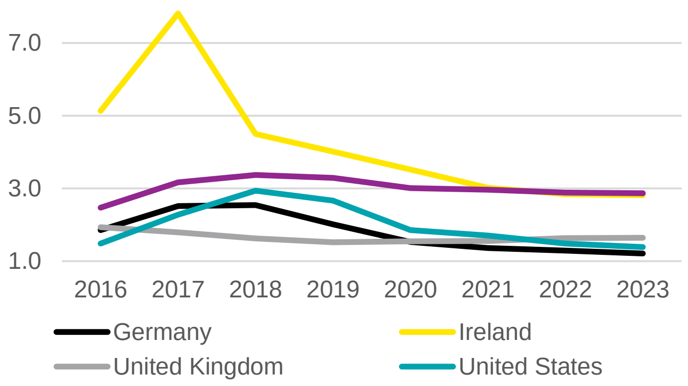
The International Monetary Fund releases latest forecasts

The IMF released its Regional Economic Outlook for Europe this week, aptly titled: Managing the Upswing in Uncertain Times. This is particularly pertinent for Ireland, where GDP growth rates of 7.8 per cent in 2017 make it the fastest growing economy in the EU. At the same time, the relative impact of a yet unspecified Brexit will likely cause an economic shock to a wide range of sectors – the degree of which is unknown.

The Outlook highlighted that Ireland is the only European country to have export-led growth, with the UK and Finland having balanced growth, and all other countries being driven by domestic demand.

As Figure 1 shows, the IMF predicts that Irish growth will cool and fall in line with the global average over the period 2018 to 2023. Importantly, this forecast takes uncertainty within the EU into consideration.

Figure 1: GDP annual % growth at constant prices, forecasts from 2018 to 2023



Source: IMF World Economic Outlook Database

The report suggests that European governments must do more to take advantage of the favourable economic conditions, before the next downturn or economic shock. It recommends working to reduce debt and implementing reforms now, while growth is strong.

One practical recommendation is to create the equivalent of a Rainy Day Fund called the Central Fiscal Capacity (CFC). The IMF outlined it would be a fund all members pay into but 'could employ something known as a 'usage premium', through which a country pays a premium in good times based on transfers it got in bad times.' It is questionable whether there is a political appetite for such a move.

Lessons Learnt?

Business will not wait for politics to adapt

The latest updates show an interesting nuance of Brexit: businesses are acting under an assumption that the UK will leave the single market – without being given political or economic clarity.

Forecasts will never be able to include all factors which influence growth, however, the IMF prediction for Irish growth shows a significant relative decrease from its unsustainably high current levels. Though notably, growth remains projected to be towards the top of the European growth league. While likely imperfect, bearing this in mind when informing policy or business strategy could help prevent exposures.

In April of this year, the FT did an analysis of how pre-referendum forecasts measured up against the post-referendum outcomes. Economists for Brexit were found to have been greatly over-optimistic in their forecasts, and the UK Treasury to be over-pessimistic.

Perhaps this suggests the wisest approach is to look at a range of possible scenarios and, where possible, prepare for each.

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