EY DKM

Brexit Watch

Monthly briefing on Brexit developments

In this issue

- **Tánaiste warns of difficult summer talks**
- **Brexit bill becomes law**
- **Brexit and firm's supply chains**

The Brexit bill has come into law this week, enshrining the date and time that the UK must leave the EU. On the 29th of March at 11pm, the UK's separation from the EU will be official. However, in the two years since the Brexit referendum result, little clarity has emerged on the post-Brexit landscape and how it will function in practice.

It was always going to be complex, and limited progress reflects the layers of negotiation, both internally and externally, required to achieve a positive outcome. Significantly more negotiation will have to be undertaken between now and deadline day to have functioning agreements in place by the time the UK leaves.

In recent communications, the Taoiseach surmised that it could take many years to hammer out a trade deal with the EU and the UK. This ambiguous timeline will provide little comfort to business leaders in their decision making.

An Taoiseach's statement, as well as the past negotiations, may not do much to grow confidence in the UK or the EU. Businesses require stability upon which to take future decisions. With the UK due to leave the EU in less than ten months, the question is raised as to what direction business leaders will follow. Options include taking a pragmatic approach and beginning to move operations, or part thereof, from the UK to Europe, or waiting, and weighing up the options later.

According to the latest EY Brexit Tracker, Dublin is now the most popular post-Brexit location for UK firms over European peers like Frankfurt, Luxembourg and Paris in terms of company moves.

Visiting Ireland this week, Christine Lagarde pointed to the remarkable change in the Irish economy since 2013. Lagarde also focused on Ireland's need to prepare for an influx of financial firms and plan for future international economic shocks after Brexit. Part of that preparation would involve setting up a 'rainy day' fund, she concluded.

Ms Lagarde also laid out recommendations to make the Eurozone more resilient by integrating financial and capital markets to allow firms to raise finance more easily through cross-border transactions.

Issue 30| 29th June 2018

Sarah McDowell
Economist | EY-DKM
Economic Advisory

Seán Golden
Economist | EY-DKM
Economic Advisory

Kathy Stout
Economist | EY-DKM
Economic Advisory

1 Political developments

Ireland

Head of IMF recommends Ireland boost regulatory capacity in wake of Brexit

Christine Lagarde, Managing Director of the IMF has said Ireland and the EU must prepare for an uptake in the number of financial firms locating here after Brexit. She warned that this increase would warrant a bolstering in regulatory and supervisory capacities across Europe. Ms Lagarde also spoke about the proposed IMF backed 'rainy day' fund for the EU. While a final arrangement has not yet been agreed, she reiterated that member states will still have to comply with shared fiscal rules and also decrease public debt where needed.

'Ireland is not alone'

These were the words spoken this week by European Commission President Jean-Claude Juncker. While visiting Dublin to discuss the current impasse over the 300 mile Irish border, he delivered a number of statements but little definitive progress was made. Juncker reaffirmed his previous comments, saying 'Ireland is not alone,' 'Ireland is backed by 26 member states and the Commission,' and 'Ireland has to be part of the deal.' Enhanced clarity in relation to the Irish border issue was not provided, other than confirming that more work needs to be done.

An Taoiseach, Leo Varadkar, gave a statement which suggested negotiations may continue for 'many years.' In relation to a trade deal between the UK and EU, it is becoming clear that this issue may not be solved by the time the UK is due to leave the EU in 2019. The lack of progress on the North-South border issue spurred Micheál Martin, the Fianna Fáil leader, to criticise 'the tough talking of [the Irish] Government' as 'over-hyped and more focused on headlines rather than substance.'

Tánaiste warns cabinet to expect 'very difficult' summer Brexit talks

Tánaiste Simon Coveney has accused the UK Government of revisionism in terms of what it has already agreed to, in order to avoid a hard Irish border. The Irish Government wanted progress to be achieved by June, however, it is now likely to happen in either October or November.

Senior officials in the Irish capital have suggested that the UK's transition period post-Brexit, may be extended. This points to the fact that progress is far from where anyone had expected it would be since the Brexit vote took place.

Economic Performance

European Union

Available from EuroStat

- Production in construction increased by 1.8% in the euro area and 1.2% in the EU28, from Mar 2018 to Apr 2018
- The job vacancy rate in the euro area was 2.1% in Q1 2018, up by 0.1% QoQ. In the EU28, the job vacancy rate was 2.2% in Q1 18, up by 0.2% QoQ
- The per hour labour costs rose by 2.0% in the euro area and by 2.7% in the EU28 YoY
- Euro area annual inflation was 1.9% in May 2018, a 0.3% QoQ increase. EU annual inflation was 2.0% in May 2018 increasing by 0.5% QoQ

Great Britain

Available from the ONS

- The Index of Labour Costs per Hour (ILCH), increased by 4.1% YoY in Q1 2018
- Wage costs per hour increased by 3.5% in Q1 2018 compared to Q1 2017
- The mining and quarrying industry saw the largest increase in wage costs of 8.1% QoQ to Q1 2018
- The basic metals and metal products industry saw the largest decrease of 7.1% QoQ
- 28% of construction workers are EU27 nationals in London, compared to 13% for all other industries

Recent Statistics

Republic of Ireland

Available from the CSO

- Employment increased by 2.9% (62,100) bringing the total number employed to 2,220,500 in 2018 so far
- Unemployment decreased by 18.6% (30,500) bringing the total to 132,900 during 2018.
- The seasonally adjusted unemployment rate decreased by 0.6% QoQ in Q1 2018 to 5.8%
- Ireland's population is forecasted to reach 5.58m by 2051 under a declining fertility and low net migration scenario according to new CSO figures

Northern Ireland

Available from NISRA

- NI output of services in Q1 18 increased QoQ by 0.7% and YoY by 1.1%
- Q1 18 showed that production output in NI decreased marginally QoQ by 0.2% and decreased 5.1% YoY
- Output in the NI production sector fell by 4.6% when comparing the most recent four quarters to the previous four quarters

1 Political developments

United Kingdom

Brexit Bill Becomes Law

A bill enacting the UK's decision to leave the EU has become law. The Withdrawal Bill repeals the 1972 European Communities Act and cements the day the UK must leave the EU as the 29th of March 2019.

British Trade Secretary Liam Fox outlined that because of the bill, the chances of Britain not leaving the EU are now zero.

Manufacturing Industry contributes to Brexit debate

A late foray into the Brexit political debate was made by the UK manufacturing industry over the past week.

The date by which ministers must decide on the UK's preferred trade relationship with the EU post-Brexit is July 6th, when Cabinet will hold a day long summit. In light of this, the business community in the UK is speaking up.

The Society of Motor Manufacturers and Traders (SMMT), BMW, Siemens, Honda and Airbus have all warned against a hard Brexit and have emphasised the serious implications a no deal Brexit scenario will have on their industry.

The SMMT has warned that approximately 860,000 jobs may be at risk. The ideal outcome according to the industry, would be if the UK remained in the Customs Union and single market.

Business Secretary Greg Clark, earlier this week announced that the aerospace manufacturing industry directly and indirectly employs approximately 300,000 people in the UK with an average annual salary of £41,000.

Mr Clark also reinforced the point that companies, like Airbus, should be listened to in relation to the Brexit negotiations.

Protestors take to the streets

In conjunction with a push from the manufacturing industry, as many as 100,000 people took to the streets last week in support of a second Brexit vote.

Labour, Conservative and Liberal Democrat supporters all marched together in a show of force, signifying that opposition to the UK's departure is far from placated.

Nicolas Maclean, a former adviser to Margaret Thatcher outlined that '[Ms Thatcher] would be turning in her grave,' in relation to Brexit.

European Union

European Council give go ahead for negotiations

Earlier this week, the European Council authorised negotiations which will clarify what proportion of European Union tariff rate quotas (TRQs) will be allocated to the United Kingdom, post-Brexit. Previously these quotas belonged to the EU28, so were shared between the UK and the other 27 member states.

It is unclear if this will be a lengthy and complex negotiation process, or as simple as allocating the UK 1/28 of the overall total.

However, demographics and geographical size could also factor into the negotiations which could further increase the complexity of the negotiations.

There has been much time spent debating the future trade deals between the EU and the UK, now could be a time to consider external talks between the EU, UK and other WTO members.

In order to modify the concessions of the General Agreement on Tariffs and Trade, the EU needs to conduct negotiations with relevant WTO members.

Furthermore, the UK needs to begin the procedures outlined by the WTO for setting out its own propositions for trade with other WTO members.

Northern Ireland

Relationship Dynamics Continue to Fray

The lack of a Northern Ireland Assembly has resulted in Nigel Dodds, Deputy Leader of the DUP, accusing Sinn Féin of becoming glorified lobbyists. The refusal of Sinn Féin to attend the Northern Ireland Executive and Northern Ireland Assembly has angered the Deputy Leader.

Northern Ireland has been without a functioning government for the past 18 months, due to a collapse in the power sharing agreement between Sinn Féin and the DUP.

Stumbling points in subsequent attempts to restore power sharing include issues surrounding same-sex marriage and the Irish language.

It is unclear whether the Northern Ireland assembly will be restored in time to discuss the looming trade negotiations surrounding the UK leaving the EU.

2 Economic Updates

Brexit and firms' supply chains

The UK's departure from the EU has naturally placed a focus on cross-border trade links. Whilst the interdependence of the two economies is clear, less public attention has been given to the indirect effects on firm's supply chains, or to the disproportionate effect on small businesses with less than 50 employees

Last week saw the release of the Cross-Border Supply Chain Report, commissioned by the Department for the Economy in NI. It analyses Her Majesty's Revenue and Customs (HMRC) microdata on regional trade to better understand the importance of NI's trade links with the Republic. Data from 2016 shows ROI-destined exports totalling £3.4billion which, taking 2015 imports as static, would mean a trade surplus of £1.4bn for the North. The report also analyses the nature of exports and the profile of exporters, with two thirds of goods exported to the South classified as bilateral agri-food or intermediate. This highlights the prominent role of cross-border trade in the supply chains.

A number of Northern Irish businesses currently transit goods for sale in Great Britain through Irish ports. NI's sales to GB are around 4 times that of sales to the Republic. The customs paperwork required for such transit in to and out of the EU, despite the final destination of goods being GB, represent an additional cost burden for NI firms. In response, NI exporters may ship directly from NI to GB, instead of going through RoI.

The Chief Executive of HMRC surmised that the cost to UK businesses could total £20billion per annum, and though this estimate has been widely criticised, it indicates that additional business costs will be incurred.

The additional time taken by such customs bureaucracy could also prove damaging for cross-border supply chains. Qualitative accounts featured in the study attest to the preference in NI for local supply chains due to proximity and quick turnaround. With consumption goods comprising 53 per cent of NI's exports to Ireland – mainly meat & fish, foodstuffs and dairy – timeliness is key. Were turnaround times to rise markedly, there is a risk that Irish importers may source inputs elsewhere.

Those affected most are the least equipped

Small businesses rely heavily on cross-border trade: they comprise just over 10 per cent of the value of exports to Ireland but perform almost three quarters of export deliveries to same (the true figure is likely to be larger, as the study is restricted to VAT-registered businesses only). Small businesses are also less likely to have a Brexit plan in place relative to larger counterparts; only 3 per cent of companies with fewer than 10 employees have one, but represent 95 per cent of employment in NI.

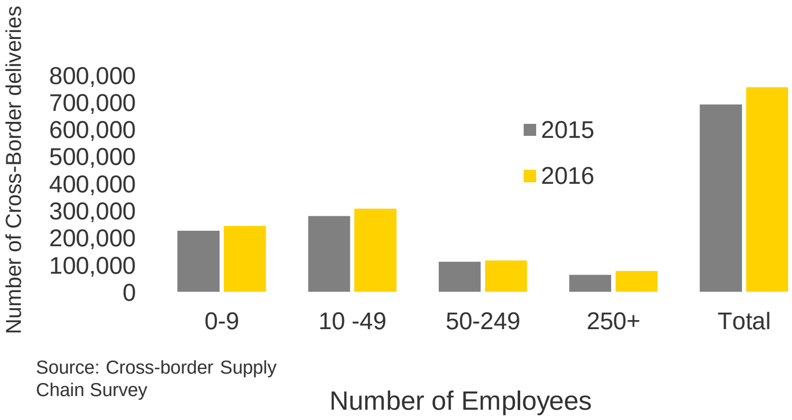
Not a one-way street

Irish exporters are similarly exposed to customs regulations. A recent report by Intertrade Ireland highlights that, whilst NI receives 10-12 per cent of Irish exports, this is concentrated in a small proportion of firms. For 1 in every 4 Irish firms, NI receives 95 per cent of all their exports.

Furthermore, the figures point to a high level of product turnover and variety, which increases as firm size decreases. This indicates the importance of cross-border trade in facilitating entrepreneurship and innovation.

Irish exporters also face the prospect of trade with Great Britain - as well as NI - suffering under a hard Brexit, indeed some have said the border issue is a 'distraction' from the West-East problem.

Figure 1: Number of export deliveries to Ireland by number of employees, 2015-16



Source: Cross-border Supply Chain Survey

A proactive approach

The island of Ireland and its firms face unique challenges that their counterparts in Great Britain may not. The small representation of NI in the wider British negotiation team means that firms must adopt a proactive approach in the coming months.

Given that scenario planning is a speculative, firms must adopt a proactive attitude and take practical steps. One such measure is to work towards and attain Authorised Economic Operated (AEO) status, which recognises the security of the firm's custom's compliance and in return, affords simplifications and waivers for checks.

Even under an FTA, additional customs checks are likely – if only between Ireland and GB, and thus this status could prove useful.

It is worth noting that the UK purported an SME exemption from any cross-border customs regulations following Brexit. Though this was dismissed early in the negotiations, it may be worth reconsidering in light of recent data.

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organisation and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organisation, please visit ey.com.

54693.pptx. Produced by BSC (Ireland. 02/18. ED none.

Image from Shutterstock.

The Irish firm Ernst & Young is a member practice of Ernst & Young Global Limited. It is authorised by the Institute of Chartered Accountants in Ireland to carry on investment business in the Republic of Ireland.

Ernst & Young, Harcourt Centre, Harcourt Street, Dublin 2, Ireland.

Information in this publication is intended to provide only a general outline of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice. Ernst & Young accepts no responsibility for any loss arising from any action taken or not taken by anyone using this material.

ey.com

Contact us

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

Kathy Stout
Economist | EY-DKM Economic Advisory
kathy.stout@ie.ey.com
+353 1 475 0555

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

www.ey.com/ie/economicsforbusiness

@EY_Ireland

Follow us