Brexit Watch

Fortnightly briefing on Brexit developments

Issue 11, 21st September 2017

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DKM Commentary:

If the UK seeks to display cohesion and resolve in the negotiation process, it still has some way to go. UK Secretary of State for Exiting the EU, David Davis, has been downplaying the cost of the divorce bill to business leaders, and suggesting free trade will not be an issue. This rhetoric is at odds with reports of rising tension between the UK and the EU and accusations of inflexibility from both sides.

UK Foreign Secretary Boris Johnson's article on the opportunities stemming from a hard Brexit presents a deviation from his Prime Minister's position and more cautious message and tone. Some commentators identified the move as a leadership bid, further challenging Theresa May to unify her party. In spite of the many personal tensions on the UK side, Mrs May will aim to restore her position as a 'strong and stable' leader with a determined and achievable Brexit strategy in her highly anticipated speech tomorrow in Florence. The speech could give a much needed reboot to the stalled negotiations - yet reports that the EU has lost faith in the Prime Minister's ability to lead negotiations suggest that hopes of renewed purpose following the speech are likely to be over-optimistic

While the EU continues to face heavy criticism of inflexibility, more pliable suggestions from the Brexit negotiator for the European Parliament have been met with harsh criticism in Northern Ireland. Guy Verhofstadt's proposal that the North could remain in the single market after Brexit, thus alleviating any worries surrounding the border, has been firmly rejected by Unionists. This could perhaps indicate that the EU is not as far ahead in comprehension of internal Brexit issues as they would like to believe.

Political Developments

United Kingdom

Divorce Bill at '£60 billion and falling' – David Davis

Sky news reports Brexit Secretary David Davis as telling business leaders the divorce bill cost is at '£60 billion and falling' with the EU negotiating team seeking €100 billion. The comments were confirmed by three in attendance at the event and could attract great scrutiny from European counterparts. Davis is also reported to have told his audience the UK will enjoy 'comprehensive free trade' with the EU following the completion of negotiations. In response to the report, the Department for Exiting the European Union in Britain stated: 'the Secretary of State was clearly making a reference to unsourced figures which have long been in the public domain and which we do not accept.' Time will tell how accurate Davis is in both his figures and negotiating skills. The Financial Times yesterday speculated that Mrs May will propose a €20 billion offer in her highly anticipated Brexit speech in Florence on Friday as a means of progressing negotiations to the second phase in October.

Theresa May keeps Canada on side

Theresa May touched down in Canada on Monday to advance discussions on post-Brexit trade deals. The British Prime Minister met with her counterpart Justin Trudeau and the early signs suggest that both share interest in developing a CETA replica between the UK and Canada. Currently however, the UK is not permitted to negotiate any international trade deals until it has officially left the EU. The aerospace industry arose as another key theme, given dispute between US company Boeing, and Canadian rival Bombardier. Boeing is threatening to take a competition case against the Canadian company to the International Trade Commission, which is one of the most important employers in Northern Ireland. Both Prime Ministers held a unified stance and Mrs May is expected to raise the issue with US President Trump at their upcoming engagement at the UN General Assembly this week.

New LibDem leader Vince Cable reaffirms position as 'party of remain'

Vince Cable gave his first keynote speech as the new Liberal Democrat leader at the party's conference last Tuesday, with emphasis on the importance of a soft Brexit, if any. Mr Cable called on Jeremy Corbyn and the Labour party to 'get off the fence' and fight against a hard Brexit, insinuating that 'silly public school boys' were disingenuous in their framing of the debate pre-vote. The speech addressed fears of pro-EU voters, and reasserted the LibDem stance as 'the party of remain'. Mr Cable also discussed the issue of a referendum on the final Brexit deal but suggested that it would truly be a 'first referendum on the facts, when we know what Brexit means'.

Boris Johnson's hard Brexit vision backfires

British Foreign Secretary Boris Johnson caused furore last Friday with the publication of a 4,000 word vision of a thriving UK under a hard Brexit, deviating from government strategy. The essay, published in the Daily Telegraph, quoted a previously disputed figure of £350 million that the UK would regain control of weekly, when EU commitments are abandoned. Mr Johnson has drawn criticism from both inside and outside his party and the government for advancing misleading information. Calls for his resignation have increased in volume over the week, particularly as the piece has been interpreted as a leadership bid. When asked for a reaction on her trip to Canada, Prime Minister May simply responded 'Boris is Boris'.

Ireland

Minister for Justice seeks security clarification

Whilst in Brussels last week, Irish Minister for Justice Charlie Flanagan acknowledged the progress made on the Common Travel Area in recent Brexit talks, but has requested clarification on the UK's position regarding post-Brexit security as a matter of urgency. On this issue, the Minister Flanagan stated that Ireland will be negatively impacted by the changes Brexit could bring 'more than any other EU state'. The limited information available thus far on UK – EU security has been positive for Ireland, but the Minister would like to see clarification in the British Prime Minister's upcoming speech in Florence. The British Home Secretary Amber Rudd is due to meet Mr Flanagan in the coming weeks to discuss the issue.

Taoiseach commits to getting solutions for the North

Speaking at the Fine Gael pre-Dáil think-in last week, the Taoiseach suggested developments on a North-South border are 'not close' to where they should be to progress to the next phase of negotiations, and that Ireland will not allow the process to advance until 'sufficient progress is made'. One of the three priorities set out for address in the first phase is 'ensuring the Northern Ireland peace process is not jeopardised'. The Irish government is increasing its volume regarding demands for this issue to be comprehensively examined.

European Union

European regulator in line for enhanced powers

The European Commission will release plans this week to increase the regulatory powers of Esma – the European Securities and Markets Authority– given rising concerns in Brussels of abuse of current rules by hedge funds and asset managers. The Financial Times highlights worries on the part of the Commission, particularly that countries could turn a blind eye to rule-breaking in an effort to attract business post-Brexit. In an effort to manage issues of this nature, the EU wants to enhance the role and capacity of Esma in vetting the activity of fund managers. An opinion paper published by the Authority in July suggested national regulators should take a stronger stance on policing asset management activities. The paper paid particular attention to delegation rules regarding fund management companies registered in one country, outsourcing activity to another country either in or outside of the EU.

Cross-Border Consumption

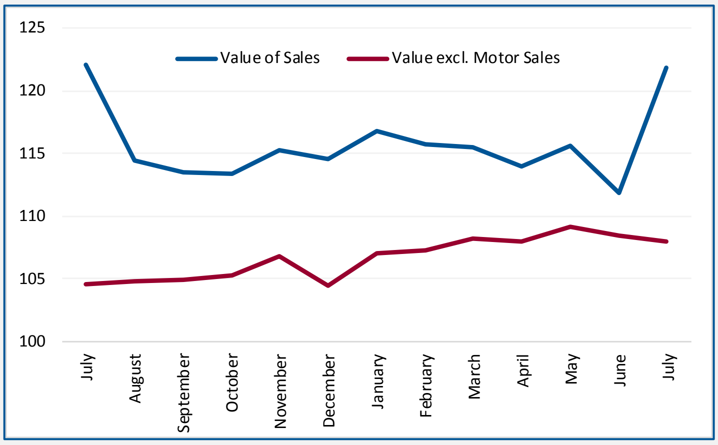
First noted impact of Brexit emerges

The CSO published Quarterly National Accounts and Balance of Payments results for Quarter 2, 2017 last week, showing that personal consumption of goods and services decreased by 1.1% from Quarter 1. Personal consumption is seen as an indicator of underlying trends as it relates to consumer sentiment. In releasing the results, Michael Connolly of the CSO intimated that the decrease in domestic consumption is very likely linked to an increase in second-hand car imports from across the border, as a result of the weaker sterling. This marks one of the first noted impact of Brexit on the national accounts. The personal consumption expenditure (PCE) figure combines spending on both goods and services but a breakdown of the two shows that spend on services actually increased by 0.2% in the quarter.

A number of recent articles in the media have discussed the contraction in consumption in quite stark terms, but it is very important to remember the context in which consumption figures are determined. The 1.1% decrease refers to a contraction on the previous quarter, but when viewed in the context of year-on-year growth, domestic consumption has been doing well. In total, PCE has increase by 1.7% compared to quarter 2 2016, with 3.0 and 0.9% growth in goods and services consumption respectively. Car consumption is down; however it is one of the few sectors to see negative growth.

Figure 1 below for all retail sales (blue line), as well as all retail sales excluding motor sales (red) as an index. The gap between the red and blue lines indicates the impact of car sales on the overall trend. With respect to the total value of sales, there is practically no change year-on-year, while a steady increase is seen in the category of 'total sales excluding motor sales', indicating the lack of overall growth is related to car sales.

Figure 1: Retail Sales Index Republic of Ireland, July 2016 – July 2017 (seasonally adjusted)

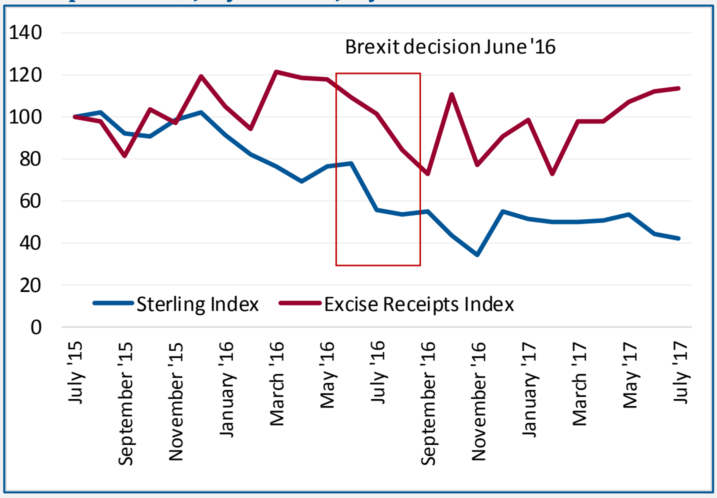


Source: CSO, Base Year 2010 = 100

Excise duty holding in face of weak Sterling

Given the weakness of Sterling, excise receipts have been a concern as cross-border shopping becomes more attractive. Figure 2 below shows Sterling value and Irish excise receipts as indices with a base of 100 in July 2015. A decline of 41 per cent is seen in tax yield from March 2016 to September 2016, in line with the decline of 29 per cent of sterling value against the euro over the same period. Morgan Stanley has forecasted that the Pound will reach parity by the euro by quarter 1 2018; however, in spite of the worsening trend for the pound, excise yields have recovered, and grown month-on-month since January, providing some good news for the Government.

Figure 2: Sterling Value Index (against €) and Irish Excise Receipts Index, July 2015 – July 2017



Source: European Central Bank and Revenue Commissioners; Base July 2015 = 100

Box A: Cross-Border Trade Under a Mix of Outcomes

InterTradeIreland has published a report on the impact of Brexit on cross-border trade flows under a number of hypothetical trade arangements, with particular emphasis on WTO tariffs. The research, undertaken by Dr Martina Lawless of the ESRI, finds that the trade-reducing effects of a non-tariff system were almost as substantial as a tariff system.

WTO arrangements would be implemented by defaut in March 2019 if a trade agreement is not reached at the conclusion of Brexit negotiations. Significant variation in tariff rates is seen across products, ranging from zero to 80%. The report estimates that exports to Great Britain and to Northern Ireland from the Republic would decrease by 8% under a WTO tariff system.

The report also indicates that given WTO tariff levels for the agri-food industry, trade mainly concentrated in this sector would be most adversely affected. With Northern Ireland's largest proportion of cross-border trade concentrated in the dairy industry, exports to Ireland would be expected to decrease by 11%.

When non-tariff barriers to trade such as quotas, standards and customs administration (e.g. documentation processing) are added to the model, it is projected trade would decline further, particularly in the short-term. As there is such a wide-range of potential policies in the 'non-tariff' category, the exact impact cannot be calculated. However, it has been determined that these policies alone could pose the same threat to trade as a WTO arrangement. The sterling exchange rate is not factored into this research, and all other variables are held equal.

Dock Watch

Relocations

XL Insurance Company SE has chosen Dublin as its new European headquarters in a bid to provide "certainty and consistency of service" to clients, following the decision of the UK to leave the EU. An Taoiseach Leo Varadkar said the insurer and reinsurer would be a "welcome addition" to Dublin's financial ecosystem and that the announcement was "a strong endorsement of Ireland's outward focus and of [Ireland's] commitment to embrace new business opportunities". XL's decision follows Beazley's announcement in July, becoming the second Lloyd's of London insurer to choose to headquarter its EU operations in Dublin.

Kroll Bond Rating Agency (KBRA) will create 100 jobs in Dublin over the next three years as it opens its European headquarters in the Irish capital. In its press release, IDA Chief Executive Martin Shanahan called the decision "another Brexit win for Ireland" and said it shows that financial institutions that may have previously considered London now view Dublin "as a viable post Brexit solution".

Ireland continues to woo the EMA

Ireland is one of 19 EU members vying to host what is considered one of the biggest 'prizes' from Brexit: the European Medicines Agency (EMA). The EMA's relocation from London is estimated to cost in the region of €580 million. According to the Irish Times, its attractiveness stems not only from welcoming the 900 highly-qualified and highly-paid paid workers, but from the revenue boost from accommodating over 36,000 visitors a year and the potential relocation of pharma regulatory offices. Ireland's pitch for the agency is reportedly one of the most generous in financial terms: offering some €78 million in grants to help with rent and staff relocation costs. It is also offering three sites in Dublin – two in the North Wall area and one close to Dublin Airport. The decision should be announced in November.

Business & Finance

Brexit moves to cost London 10,000 finance jobs

A Reuters survey of 75 finance firms employing almost 500,000 staff in London has found that approximately 10,000 finance jobs would be moved out of Britain or created overseas in the coming years should Britain fail to stay within the single market. It noted that Frankfurt was the most popular destination for these jobs, followed by Paris. It reported the views of senior executives in London that the true impact of Brexit would only become clear in a decade or two. This is because most firms are implementing a two-stage contingency plan; the first involving relatively small numbers of staff to ensure the required permits and infrastructure are in place, and the second entailing longer-term thinking about the shape of the firms' European businesses

CEO Pulse survey indicates falling confidence in Irish economy

PwC's annual CEO Pulse survey shows that the majority of Irish CEOs (58%) are confident about the economy. However, this figure is down from 71% last year. Similarly, a majority (66%) are confident about future prospects for their business, but this has also seen a fall compared with the 2016 survey (71%). However, the percentage of Irish CEOs "very confident" about revenue growth has increased by 3%. High personal tax burdens/increasing tax compliance was considered a concern for 93% of Irish CEOs (up 16 percentage points from 2016), while Brexit was considered a concern for 89% (down 4 percentage points from 2016).

Farmers' Brexit concerns being realised

Ahead of the Ploughing Championships this week, President of the IFA, Joe Healy has said that Brexit is "probably the biggest challenge in any of our lifetimes.' Mr Healy noted that the effects are already being felt, with beef farmers losing €2 million per week over the past month due to the decline in sterling.