Brexit Update

AIB Treasury Economic Research Unit

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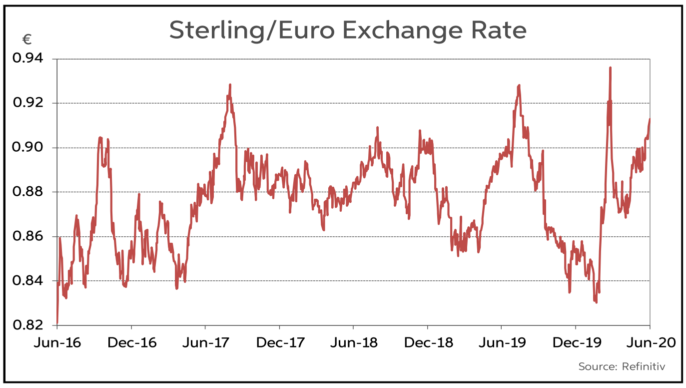
Possible EU-UK trade deal: Half a loaf is better than none

The EU-UK trade talks made very little progress over the first half of the year. This has been one of the factors behind the renewed weakening of sterling, with the euro climbing above the 91p level recently from 84p earlier in the year. The UK has ruled out any extension to the Brexit transition period beyond end 2020 that would allow the negotiations to be prolonged into next year. Thus, markets have been concerned that we could be heading for another cliff-edge Brexit date in December, with a growing risk that a trade deal will not be agreed. This would see the UK moving to trade under WTO rules from the start of next year, with the imposition of tariffs on some goods, in effect a hard Brexit.

The trade negotiations have been fractious, with neither side prepared to give any ground. **More recently, though, there has been some signs of movement on both sides,** while meetings this month between the UK Prime Minister and a number of EU Leaders would appear to have added fresh impetus to the talks. 'Intensified' negotiations, to include some face-to-face meetings, are starting today, June 29th, and will continue during July, before hopefully resuming in September. A trade deal would need to be finalised by October to allow sufficient time to have it ratified by end year and take effect from 1st January 2021.



The issue of regulatory alignment and a level playing field on trade has been a major stumbling block in the negotiations. There have been signals from the EU that it could be prepared to soften its stance on this, especially regarding state-aid rules. Meanwhile, the UK may be prepared to accept some form of common minimum regulatory standards, that would still allow it to set its own rules subject to this constraint.

The EU will be careful, though, that any deal does not undermine the integrity of the Single Market and that there are obvious major advantages to being part of the Single Market rather than outside it. Agreement on the other main issues in the talks—fisheries rights, cooperation on security arrangements and governance via some form of disputes resolution mechanism should be easier to achieve if real progress is made in the trade negotiations over the summer.

Both sides seem keen to conclude some form of trade deal. Neither will want to endanger a recovery in activity next year from the current very deep recession by heaping tariffs and trade restrictions on businesses and risking a fresh economic shock. **However, given the limited timeframe for the negotiations, it looks like it will be just a minimum trade deal, largely focused on avoiding the imposition of tariffs and quotas on merchandise goods.**

It is unlikely to extend to the services sector, the main export engine of the UK economy, most notably financial services. **It will be a pale shadow of the current Single Market** and, indeed, the comprehensive free trade deal that was promised at the time of the Brexit referendum in 2016. However, even a minimal trade deal would limit the immediate economic shock of the UK leaving the Single Market. It should also provide the basis for continuing cordial relations and could be built on in future talks in the year ahead. In this instance, it is certainly the case that half a loaf is better than none at all. A no-deal outcome that sees the UK revert to trade under WTO rules would be a severe blow to both the Irish and UK economies. Both countries are striving to overcome the deep recession triggered by the coronavirus pandemic and the additional costs this is imposing on many businesses.

Even just a 'bare-bones' trade deal should allow sterling recover some of the ground it has lost since earlier in the year. However, the gains by the currency are likely to be limited as the UK's departure from the EU Single Market for a new much inferior trading relationship will inhibit the growth of the economy over the medium term. Thus, the euro may only fall back to around the 87-88p level, comfortably above the 83-85p range it occupied over January-February.

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Firms need to be ready for big changes in trade with the UK from 2021

Trade will be far from frictionless under a FTA, with increased administration, compliance and delays. While not the same as a full hard Brexit and a reversion to WTO rules involving tariffs, trading with the UK under a FTA will become much more difficult and costly for both exporters and importers, with negative economic consequences. **Businesses will need to prepare for a markedly changed trading relationship with the UK under a FTA.** In particular:

- *UK will be outside EU Customs Union so both exports and imports will need* ***new paperwork****, even if tariff free trade is agreed that implies no Customs Duties*
- *Get registered to continue trading – will need* ***Customs Registration Numbers*** *for both Ireland (EORI) and the UK*
- ***Customs Declaration forms*** *will need to accompany all goods – firms may need a* ***Customs Clearance Agent***
- *Establish with Revenue if a* ***Deferred Payment Bank Account*** *is required to cover any Duties or VAT on imports. Firms will need to contact their bank if they need to open such an account*
- *Trade in some agri-food products* ***may require additional veterinary checks and health certs***
- *Compliance with* ***onerous rules of origin*** *could be required for some goods*
- *Check with their suppliers and customers that they have new paperwork in place*
- ***Land bridge route via Great Britain*** *to mainland Europe will also be impacted. It will probably need transit documentation and possibly sealed containers, with delays likely at ports*
- *Establish if* ***cash flow*** *impacted by trade frictions and increased costs that requires additional working capital*

Move to FTA will lower economic growth

Both Copenhagen Economics (CE) and the Irish Central Bank have published studies that try to quantify the impact on the Irish economy of an EU-UK FTA that replaces the Single Market. **The Central Bank estimate that it would lower Irish output by 3.5% in the long run, while CE put the negative impact at 4.3%.** CE also estimate that a favourable free trade deal that was based on the Revised EU-UK Political Declaration agreed last October would reduce GDP by between 3.2% and 3.9%, though such a deal now seems unlikely.

A number of studies have estimated the impact of a FTA on the UK economy. The National Institute for Economic and Social Research puts the long run reduction in GDP at 3.5%, the IMF at up to 3.3% and the UK Treasury at 4.9%. **The impact on growth in both economies is likely to be felt over time given that trade would not suffer an immediate impact from tariffs and quotas.** Indeed, the indications from the UK government are that it is planning to implement a light touch regulatory regime initially in regard to goods coming in from the EU. Apparently, the UK will not have the necessary infrastructure in place in time to do full checks on EU imports when new trading arrangements come into place in January.

It is not surprisingly that **the expected impacts on the UK and Irish economies of a move to a FTA are broadly similar** as the UK is very dependent on the EU market (takes 45% of exports), while 40% of Irish indigenous exports go to the UK.

It is also estimated that if a deal is not agreed and the UK moves to trade under WTO rules, in effect a hard Brexit, the economic impacts on the UK and Irish economies would be broadly the same too. Most studies, suggest that the hit to GDP in both countries could be of the order of 5-7%, with the impacts very much front loaded into the first couple of years. This is the last thing that businesses that are trying to recover from the recessionary impact of the restrictions put in place to contain the spread of the coronavirus, would want to see.

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