Brexit Update

AIB Treasury Economic Research Unit

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Brexit faces an uncertain future

Last week's EU Leaders' summit concluded with the UK being granted another extension to the Article 50 process to the end of October. It is important to note that the new Brexit deadline is not a fixed date. The UK could leave at any time before then. It should also be noted that the recent longer extension to Article 50 does not rule out granting the UK a third extension, if agreed by all the EU 27 member states.

The focus and onus is now very much back on Westminster. We would not be that confident that the UK Parliament will be able to ratify the Withdrawal Agreement (WA) during the next six months, paving the way for Brexit, or indeed, agree on an alternative way forward. The WA has been defeated on three separate occasions in the House of Commons. Meanwhile, attempts by MPs to find consensus on alternatives to the WA in so-called 'indicative votes' have also so far failed.

One area where consensus among MPs has been found is on avoiding a no-deal exit. The House of Commons has voted by a large majority against leaving the EU without a deal. However, it needs either to pass the WA, agree on an alternative or revoke Article 50 to avoid this, as otherwise the default position is the UK leaves the EU without a deal in the absence of a further extension to Article 50 being granted by the EU. More recently, the Conservative and Labour parties have been engaging in cross-party talks to try and find common ground on Brexit. However, the chances of the impasse being resolved remain low given the different views (incl. Customs Union, second referendum) between the respective parties and the sharp divisions within the parties on these issues too.

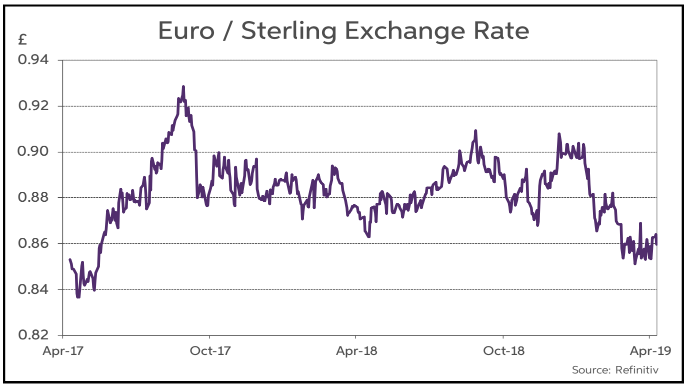
Given the on-going delays to Brexit, there is an increasing possibility that Brexit may not happen at all. There are only so many times that the EU will be prepared to grant the UK extensions to Article 50, before asking it to decide between remaining in the EU or leaving, with or without a deal.

Indeed, the UK Parliament could decide later this year that if it still cannot resolve the Brexit impasse then it has no alternative but to put the issue back to the people in a new referendum. Remaining in the EU is likely to be an option in any such referendum, together with at least one option on leaving the EU. Overall then, in our view, the on-going Brexit delays, amidst a continuing political logjam in Parliament, increase the prospects of the UK remaining in the EU.

In summary, there appears to be four potential Brexit outcomes. These are (1) No deal exit, (2) Remain, (3) Ratify the WA or (4) Extend Article 50 again. There is also the possibility of a general election in the UK and/or a new referendum.

Sterling range bound for the moment

From a currency perspective, sterling has taken the recent events of the past month in its stride. The EUR/GBP rate has been largely confined to a narrow 85-87p trading range since mid-February. These levels indicate that the market is not overly concerned about the risks of a no-deal/hard Brexit materialising.



The currency could continue to mark time in the next couple of months, amid on-going efforts to get the WA ratified. Although the upcoming elections (local elections on May 2nd and European parliament elections on the 23rd) in the UK do present some event risk for the currency. We only see sterling making gains where remaining in the EU becomes a growing probability, most likely through a new referendum. On the other hand, the currency could start to edge lower as the new Brexit deadline approaches in the autumn, if the risks are rising that the UK may leave the EU without a deal.

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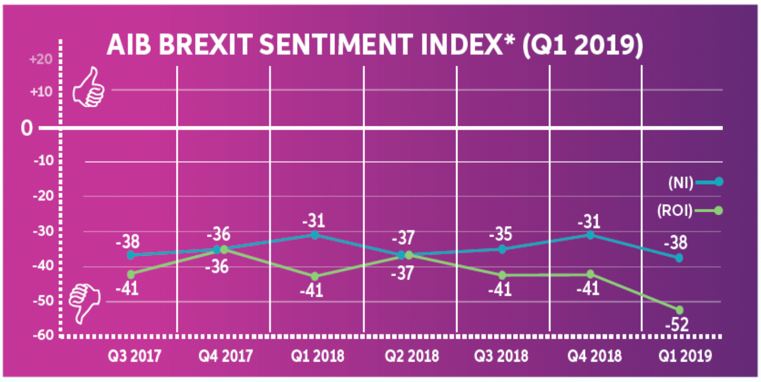
Even if the WA is ratified and the UK departs the EU, there are still likely to be choppy waters ahead for sterling. Difficult talks will follow on the future relationship between the UK and EU, with the aim of concluding a broad trade deal. It is very unclear what the outcome of these talks will be, so uncertainty about Brexit could persist for quite some time after the UK's departure from the EU, acting as a headwind for the currency.

Meanwhile, a hard Brexit could still arise via a number of routes, either in October or at some later date. Sterling would come under severe pressure in a no-deal hard Brexit scenario. The currency could fall by 10-15 per cent from current levels in such circumstances. Indeed, the Bank of England has forecast that the currency could fall by as much as 25% in a disorderly no deal Brexit.

Brexit weighing on Irish business sentiment

The AIB Brexit Sentiment Index (BSI) is based on a quarterly survey of 700 Irish SMEs on both sides of the border. The UK's pending exit from the EU has had its biggest impact to date on Irish business confidence in the Republic of Ireland in the first quarter of this year. The BSI baseline is zero, with a potential range from +100 to -100. For Q1 2019, the index registered a score of –52 for RoI businesses, down from –41 in Q4 2018. Sentiment amongst Northern Ireland businesses was also lower at –38, down from –31 in Q4'18. Although, this is similar to the levels registered in some previous surveys.



Source: Ipsos MRBI

*The Index reflects and measures the sentiment of Irish SMEs in the Republic of Ireland and Northern Ireland towards Brexit, summarised as a single number, with a potential range from +100 to -100. It takes the difference between the positive and negative responses across four key measures: Impact on business now, Impact on future business (next 5 years), Level of visibility and, finally, the Wider economic impact of Brexit.

The rise in negative sentiment in the RoI is being driven in part by concerns among SMEs that Brexit is starting to 'impact business now' - 46% of respondents said that it was impacting their current business conditions. This is up from 25% and 32% in Q3 and Q4 2018, respectively.

Sentiment has also been dented by deepening concerns amongst an increasing number of Irish SMEs about the future impact of Brexit. In this regard, 76% of RoI respondents in Q1 stated that Brexit will have a negative impact on their business in the future, up from 63% in Q3'18 and 68% in Q4'18. Meanwhile, 81% of firms are expecting the wider economy effect to be also negative.

The deterioration in business sentiment was evident across a range of sectors in the survey. Indeed, sentiment has dropped to new lows in most sectors**.** The food and drink sector was the most negative, recording an index reading of -56, followed by tourism (-55) and retail (-53) and manufacturing (-50) sectors. Meantime concerns over Brexit continue to impact investment plans, with 53% of RoI SMEs that planned to invest in their business, now either reviewing, postponing or cancelling these plans.

On a positive note, in light of the heightened uncertainty surrounding the UK's exit from the EU, there has been an increase in the percentage of Irish firms planning for Brexit. In the RoI, 64% of businesses stated that they have started, or completed their formal Brexit planning. This is up from 48% in the last quarter of 2018.