Brexit Update - FX and Sectors

October 2020

As the path of Brexit enters its crucial final phase, this is the second in a series of updates designed to cover the latest developments, including currency markets and sector specific analysis on key sectors affected by Brexit such as Agriculture, Food & Drink and Manufacturing.

Latest News

The latest set of Brexit negotiations have failed to produce a breakthrough in the key areas of the Level Playing Field (including State Aid), Fisheries and Governance. UK Prime Minister Boris Johnson had previously set a deadline of October 15th to agree a deal. With this date now passed the UK Prime Minister has warned that the UK will get ready to leave the bloc's single market and customs union at the end of the year without a new agreement in place. Despite this, and the stalled negotiations, both sides have still left the door open for further talks in the coming weeks which means the path to a deal remains in place for now.

In recent weeks, the headlines from negotiations had struck a more positive cord – particularly from the UK side who made clear their intentions to bring talks into the final intensive 'tunnel' phase. EU negotiators remained resolute and insisted that insufficient progress had been made to bring talks into the 'tunnel'. While there is some suggestion of progress in the areas of the Level Playing Field and Governance, the EU have taken a tougher stance on Fisheries which has divided discussions.

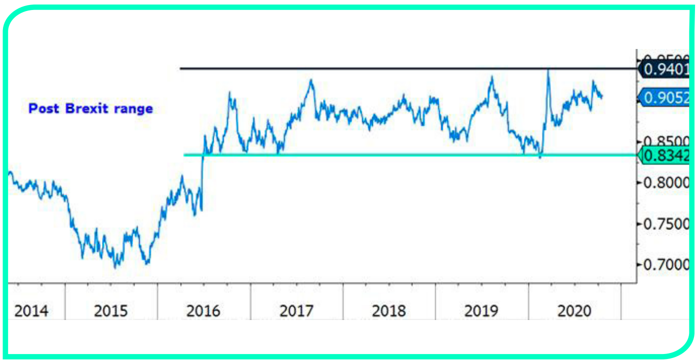
Recent **media reports** suggest that *'despite the rhetoric on both sides, a deal should be doable whereby EU fleets lose some fish quota but keep a considerable amount of their access to UK waters in such a way as to allow both sides to dress the outcome up as a victory.'*

A further key area of focus will be on the Internal Markets Bill which is due to begin it process in the UK House of Lords. EU member states have previously warned that in order for a deal to be finalised, the UK must remove articles of the Bill that override aspects of last year's Withdrawal Agreement. UK legislators are likely to pass the Bill however they are expected to reject the more controversial clauses. The coming weeks will see the progress of the Internal Markets Bill in the UK House of Lords and ongoing discussions on the key aspects of a trade deal. Michel Barnier had previously set out a deadline of the end of October to agree a deal however like the UK, the door is also expected to be left open by the EU if both sides can't agree a deal by then.

Currency Update

Euro/Sterling has fallen by about 2% since the middle of September when the pair traded close to 93p for the first time since March of this year. Currency markets had begun to price in higher probabilities of a deal as commentary from the UK side suggested further progress in talks. The Bank of England's ongoing research into negative rates has seen interest rate markets price out any further cuts to UK interest rates for the remainder of this year, this in turn has also boosted the Pound. The post Brexit range of 83p-95p remains intact despite the increasing tension in Brexit negotiations and a downgrade of the UK's Credit Rating; however recent weeks have seen a sharp increase in intraday volatility which is likely to persist for the remainder of this year.

Euro/Sterling



Source: Bloomberg

Sector Analysis – Agrifood & Manufacturing

UK Food Standards

Last week, British MPs rejected an amendment to the UK Agricultural Bill which would have forced future UK trade deals to meet UK animal welfare and food safety rules. This was a major blow to British farmers and the agri-food industry. Farmers there are concerned that allowing foods such as chlorinated chicken and hormone fed beef from the US, for example, would undermine UK farming and food standards and make British farmers uncompetitive. The Bill would have protected the British farming industry and Irish agri-food exporters and farmers as it would have prohibited lower food standards that can be produced at lower cost from entering the UK market. The UK government says it is still committed to high standards and that existing laws would safeguard them. The plan now is that the Food Safety Agency would prepare reports on food and agricultural products before they could enter the UK market.

Rules of Origin

It is now expected that the UK will define its rules of origin so that Irish cattle and pigs slaughtered in the North can be sold in the British market without any tariffs – even if no trade deal is reached between the EU and UK. The rationale is that the process of slaughtering and deboning is considered to add enough value to the product within the UK, to effectively make it a UK-origin product. This could provide a solution where beef exports from Ireland could avoid some of the potential €750m tariff to be imposed on beef in a no deal scenario. It would see live exports to Northern Ireland soar; however slaughter capacity in the North would put a limit on cattle numbers. There has also been some progress on the issue of rules of origin within the context of EU free trade agreements. Revenue has confirmed that where the agreement allows for accounting segregation (such as the Canada/Europe Trade Agreement), goods from NI/ROI of a similar quality can be identified via accounting rather than physical segregation. More concerning is that in recent weeks, one of the UKs major retailers, ASDA, announced it will buy only British beef in the future. While it is a major boost for British farmers, and especially if other retailers follow, it means that Irish beef will be pushed off shelves. However as the country is only 61% self-sufficient in beef, it will still need to import a significant proportion of its beef needs.

Tariff Support Mechanism

In the case of a no deal Brexit, there are hopes amongst industry bodies that the Government would be able to protect agri-food exports by developing a tariff Support Mechanism. In a no-deal scenario tariffs in excess of €900m could be imposed on Irish meat exports to Britain. Recently a €5bn Brexit Adjustment Reserve was established and this could be tapped along with the future tariff revenue stream from the UK to provide exporters with supports in order to offset tariffs into the UK. This would also mitigate against the collapse of beef markets across the EU if exports of Irish beef to the UK were to be displaced onto the EU market.

Stockpiling

In the run-up to the previous Brexit deadline, we saw stockpiling take place. It is likely that this will occur again as food buyers and retailers seek to have security of supply (in case of delays or barriers to entry) while also securing prices in case of tariffs. This could provide a window of opportunity for increased prices (particularly around beef) as it is happening in the build up to Christmas- a period of increased demand normally.

Land bridge

Concerns around delays and congestion with the land bridge after Brexit means that exporters are looking at other options. The news that another direct ferry service to France from Rosslare may start will interest exporters. This would take 50,000 of the 170,000 trucks that travel from Ireland to the continent via the UK each year by ferry and could help mitigate the delays. However a key issue is whether a new service could come close to matching the 20-hour journey time allowed by the UK land bridge. This would be important for perishable products such as seafoods or even live cattle exports. As it currently stands there is huge uncertainty for Irish agri-food exports. The most successful outcome for farmers and the agri food industry would obviously be in maintaining full access and frictionless trade between Ireland and Britain, while retaining the full value of the UK market. While a free trade agreement will help, phytosanitary checks and attendant delays are still likely to cause issues.

Fisheries

The issue of access to UK fishing waters has continued to be one of the most contentious outstanding issues. Notwithstanding its small share of UK GDP (0.1%) and the need for UK processors to access the EU market, its political significance has resulted in ongoing stalemate in the negotiations. There are indications that this is now beginning to change. The UK offered a concession of 3 years extension of access to waters to enable a longer transition for EU boats. The UK also signed a mutual access deal with Norway, agreeing to set annual quotas. A compromise using a mechanism like such annual negotiations is resisted by the EU side due to the difficulties it could pose to the industry for long term planning. Within the EU, the French are holding the line for maintaining the current access arrangements; however compromise with other bloc interests is inevitable.

Manufacturing

British carmakers could face higher export tariffs with or without a Brexit deal after the EU rejected an argument that sub-assemblies and components from non-EU countries, such as Japan, used on UK automotive assembly lines should be considered British. This idea referred to as "cumulation" under the rules of origin system has been formally rejected by the EU in Brexit trade talks. (The Guardian, 3/10/20). Should British made cars, vans and trucks be deemed less price competitive post Brexit, it could be another blow to some of our Irish automotive supply chains with contracts into UK auto manufacturers.

In September the UK government issued new guidance for manufacturers, distributors and assessment bodies on placing manufactured goods on the UK and EU market at the end of the Brexit transition period. The guidance covers conformity assessment for manufactured goods including toys, electrical and electronic equipment, and personal protective equipment; the use of the new UK Conformity Assessed mark; and how to place goods on the market in either Great Britain or the EU from 1 January 2021.

Analysis From

Lee Evans
Head of FX Strategy

Roisin O'Shea
Head of Food & Drink

Eoin Lowry
Head of Agriculture

Brian Evans
Head of Manufacturing

For Further Information

Visit our Brexit Hub
Get a clearer picture

Supports for businesses affected by Covid-19
Find out more here

Currency Risk Guide
Download here

Tariff Update
Click here

Applying for a Bank Guarantee
Check List