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The Brexit Column

Issue 7 November 2016

Hard or soft boiled Brexit? It's a question of timing

Mark Essex

Mark accurately predicted the outcome of the EU referendum four months ahead of the vote. As a director of KPMG's public policy unit, he now analyses the impact of Brexit on business.

mark.essex@kpmg.co.uk

Hard Brexit, Soft Brexit: they seem like simple terms – one representing Britain's decoupling from Europe to go it alone; the other representing its continuation within the Single Market, or the Customs Union at the very least. Yet these labels are highly malleable – a fact that could have a major impact on UK's negotiating strategy and the eventual shape of its trading future with Europe.

For instance, when is a 'hard' Brexit not hard? When it is softened by the passage of time. If the UK announced that it was leaving the Single Market 25 years from now, I doubt there would be anywhere near the current level of focus about the fate of the UK's carmakers, passporting for its banks or the question of who would staff hospital wards, factories or research labs. Time is the shock absorber that gives businesses and supply chains (on both sides of the Channel) time to plan. Make contingency plans. Adjust.

Unfortunately, the prime minister does not have the luxury of time. She was handed a mandate by the British people and neither the majority who voted to leave – nor Europe's leaders – would have accepted an open-ended promise to trigger Article 50 "at some point". Once invoked (which Theresa May insists will happen by next April, despite her High Court setback on Thursday) the rules of the EU's divorce clause are clear: a deal must be done inside two years. To compound the short timescale, we might not

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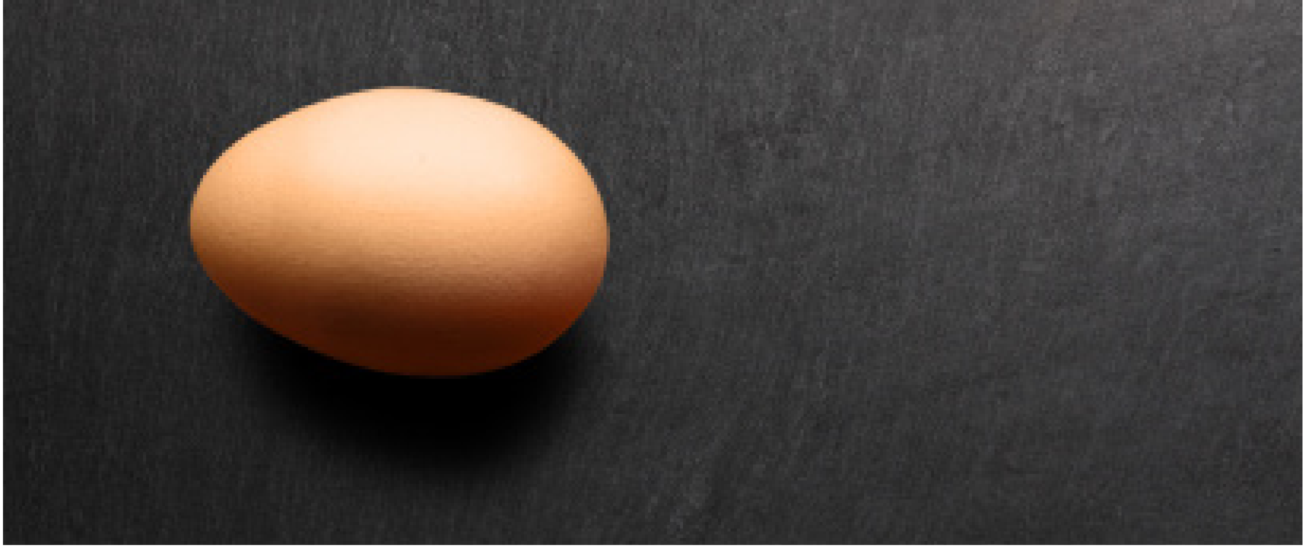

know even the vaguest outlines of the deal until its completion – giving business virtually no time to make plans and adapt.

This is where 'hard' and 'soft' Brexit again become relative terms. The outcome of negotiations will affect different sectors in different ways. For some a hard Brexit will feel like a very hard landing. For others, less so.

Eggs-tra time

The worst affected would be those with complex and costly fixed assets; those who work on long lead times and who have highly-integrated value chains with the rest of Europe. Businesses like carmakers, aerospace manufacturers or pharmaceutical firms. These companies plan their operations – and even the lifecycle of single products – in 10 to 15-year windows. Without a long notice period of a change to their terms of trade, either they need the UK to remain part of the Customs Union (to allow the free movement of goods) or they need bespoke deals. Perhaps this is why Theresa May singled out these industries for special attention in her speech at the Conservative Party conference. Other complex industries which are highly-interconnected with Europe, such as chemicals, also have a good case to feature on that list.

Though it might not feel the case for retailers right now, the effects of a hard Brexit are different for those businesses with a strong domestic footprint. On one hand, they feel the fluctuations of the pound, the pain that would result from tariffs on imports, the consequent inflation and the eventual impact on consumer spending. On the other hand, these are not unique Brexit effects but the kinds of pressures that agile, competitive businesses cope with through the business cycle. Lead times are shorter (think fast moving consumer goods) and their customer base remains within the UK. The challenge for retailers, hotels, hospitals, and yes also businesses like KPMG, is to mitigate these risks by improving productivity, upping utilisation and, quite simply, selling more.

The businesses least affected by a hard Brexit are of course those that are most mobile and with the smallest footprint. This is precisely why the debate around passporting for banks is so heated, and given their importance to the UK's tax base, also why financial services, tech and the

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creative industries featured in Theresa May's list in Birmingham.

The main concerns for these firms are access to top talent and the regulatory environment. Their first requirement seems less problematic judging by the noises from government, particularly the Treasury, which suggest that curbs on migration would most likely restrict the movement of lower-skilled workers. Their remaining demand therefore is some sort of early warning about changes to the regulatory environment. It is precisely because of their mobility, and in the absence of any certainty on this point, that many are at least considering plans to move some operations out of the UK as soon as next year.

Scrambled regs

The very different circumstances of these very different groups strengthens the case for sector-by-sector deals, as we advocated here two weeks ago. The near-failure of the EU's trade deal with Canada last week makes the argument more compelling still. The fact that a parliament in the Belgian region of Wallonia almost scuppered seven years of talks, offers a glimpse of the risk in seeking a comprehensive deal.

Add to that the fact that neither side can wait seven years to land a deal: this is not a case of purely finding the upsides (in the case of Ceta, an estimated 10 billion euros a year in extra trade); it is about nothing less than the continued success of both sides' economies. The issues that have to be resolved are far more complex, and – right now – the reserves of goodwill seem lower.

In the success of negotiations, it is as much an issue of the time businesses have to adapt to an agreement, as it is the 'hard' or 'softness' of an EU-UK deal, that will determine its effect. A holding agreement or less ambitious sector-specific deals – or a hybrid of the two – rather than the ambition of a comprehensive plan might be the best way of avoiding a hard landing on both sides.

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CREATE | CRT070295 | November 2016