Deloitte.

The Economic Impact of Brexit on Germany

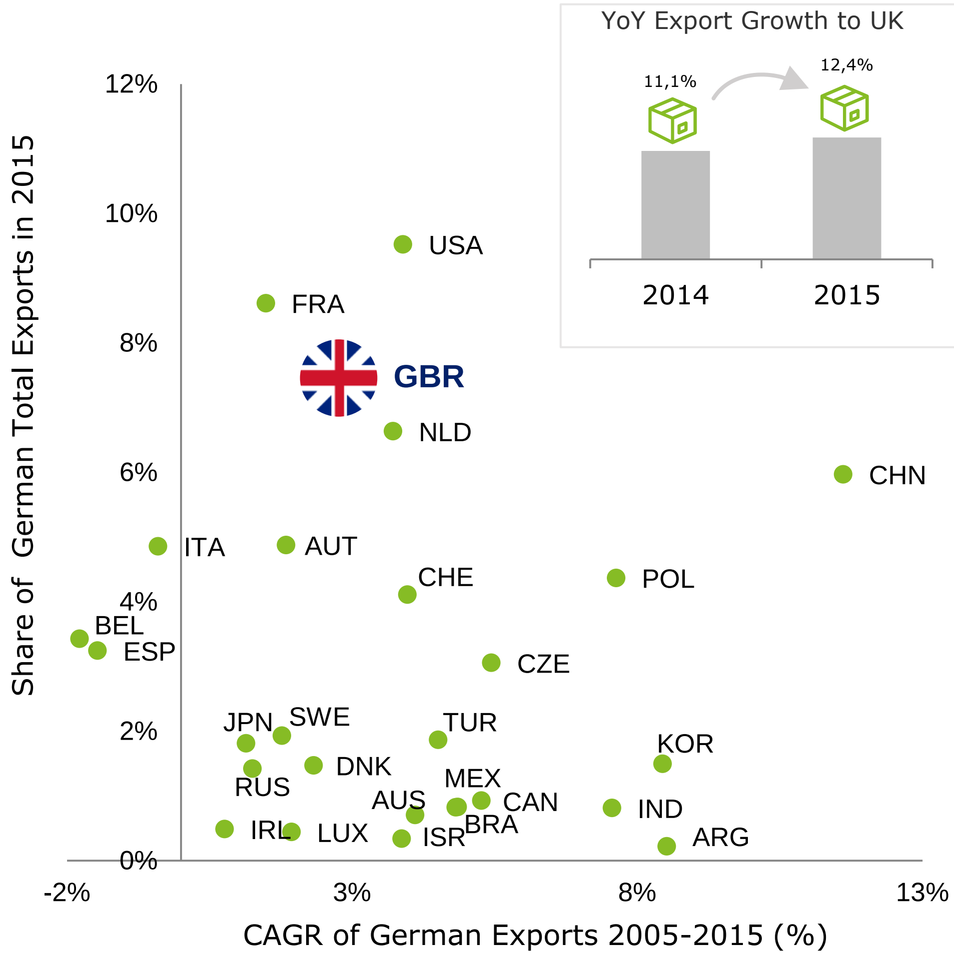
Dr. Alexander Börsch, Chief Economist, Deloitte Germany

Institute for Law and Finance, Goethe University Frankfurt,
November 3, 2016

Brexit & the German export industry

UK is a crucial export market for Germany

Germany's export structure



Structure of UK-EU trade relations

Large trade surplus of European Union (esp. Germany), based on

- Motor vehicles
- Food
- Computers, electronic and optical products
- Machinery & Equipment

UK sectors with surplus

- Financial services
- Insurance and pension services
- Other business services
- Telecommunications and information services

Very close integration of UK exports into European value chains

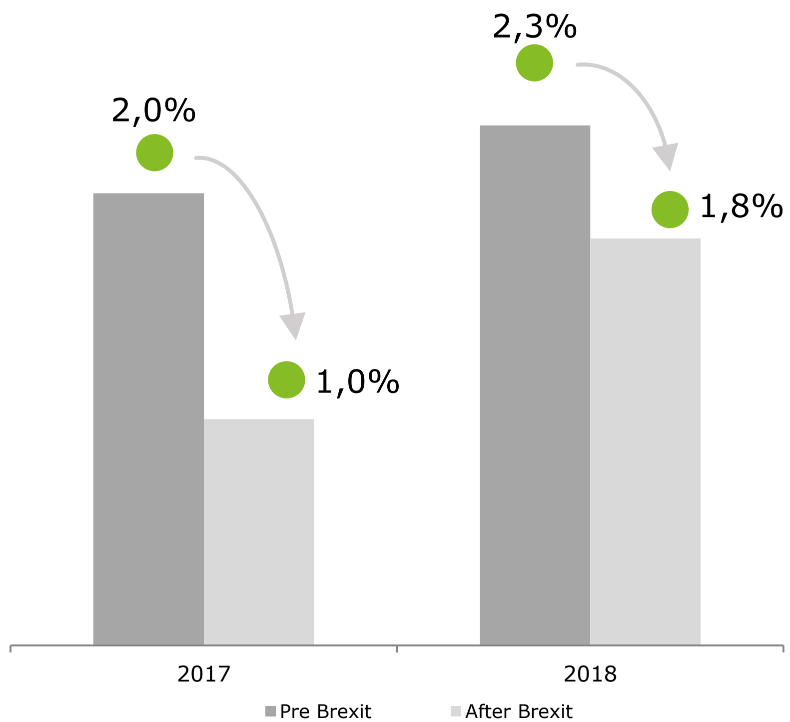
Source: German Federal Statistical Office, British Office for National Statistics, Dow Jones

Brexit & the German export industry

UK will grow substantially slower – corporates hesitant to invest

Uncertainty/investment plans UK corporates

Impact of Brexit on UK growth (change in forecasts)

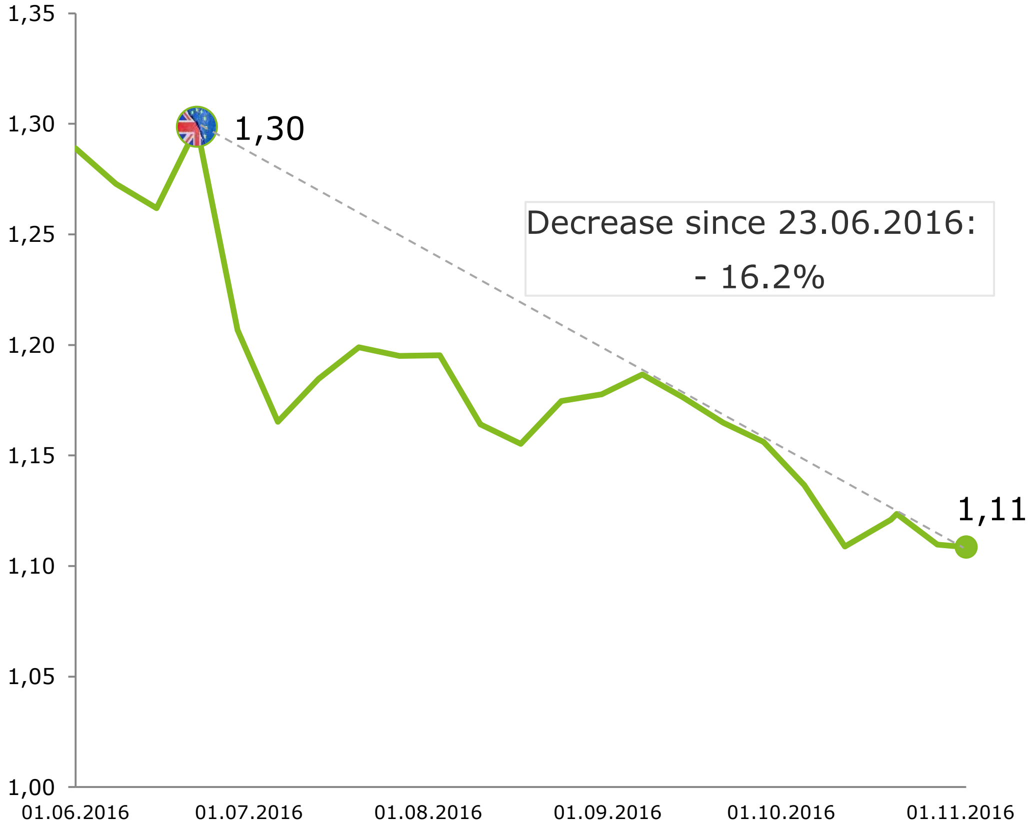


Source: Deloitte CFO Surveys UK, OECD, Bank of England

Brexit & the German export industry

The weakness of the pound affects German exporters substantially

Development of exchange rate
(Pound/Euro) since Brexit referendum



Source: IW Köln

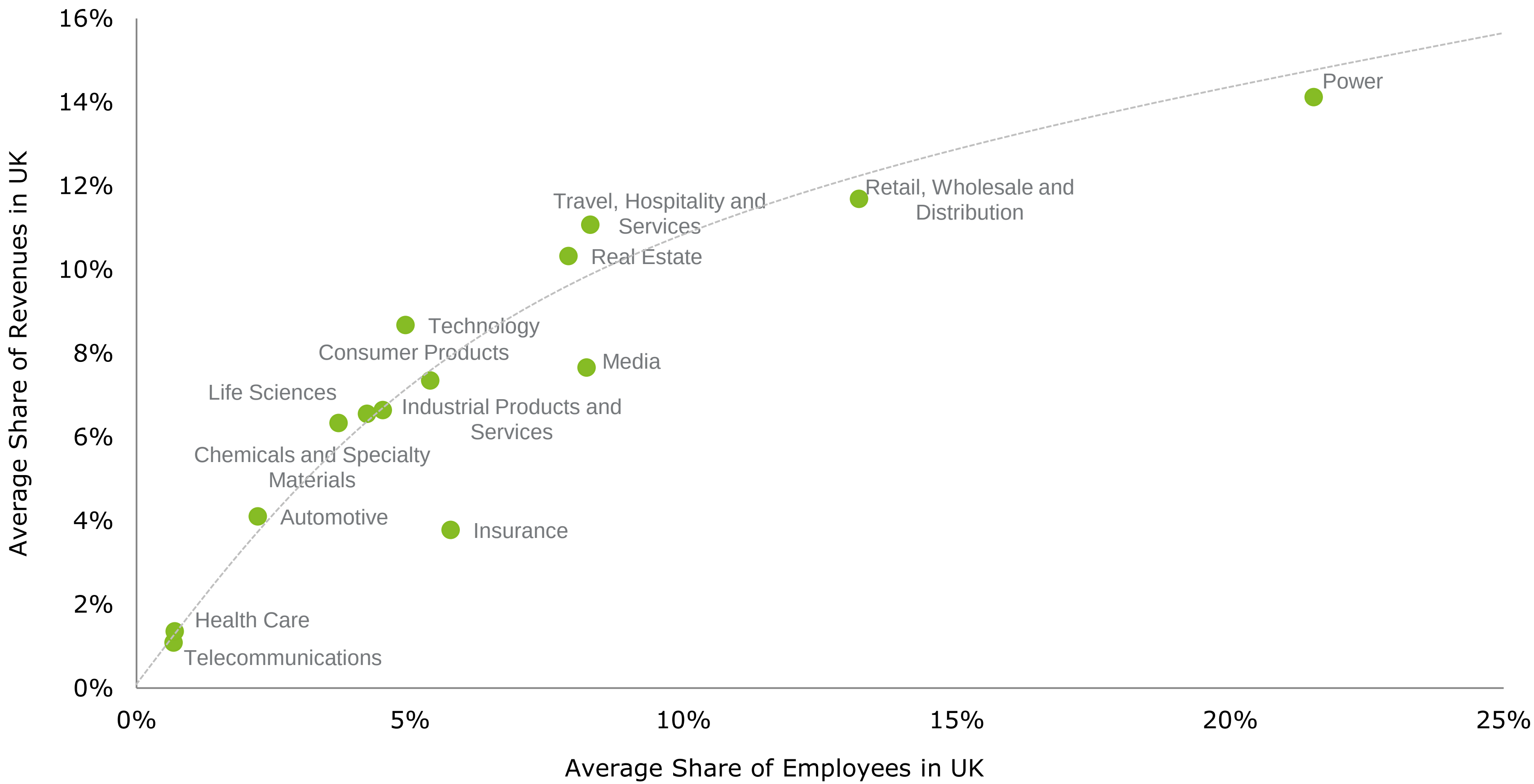
Implications for German exports

- 5% drop in pound lowers German exports by same amount
- 20% drop lowers exports by 17%

Brexit & the German export industry

The vulnerability of sectors differs widely

Exposure of German sectors to the UK



Source: Deloitte analysis based on Dow Jones data

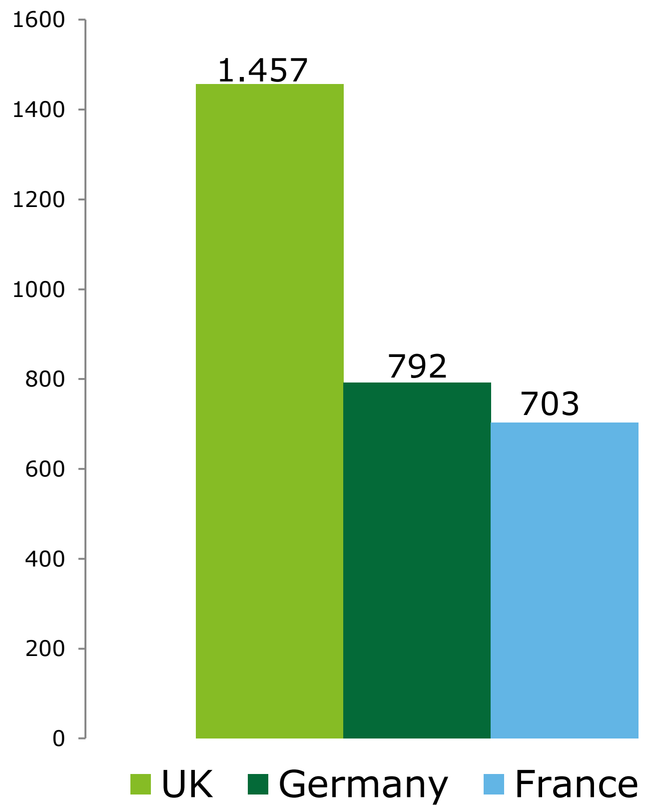
Foreign Direct Investment flows

Locational competition has started

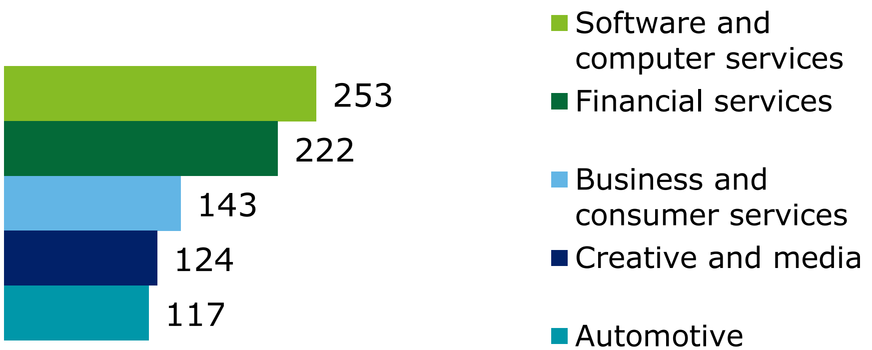
Foreign direct investment flows

Currently, the UK is the major gateway to European markets for foreign investors

FDI inward stock, US$ bn (2015)



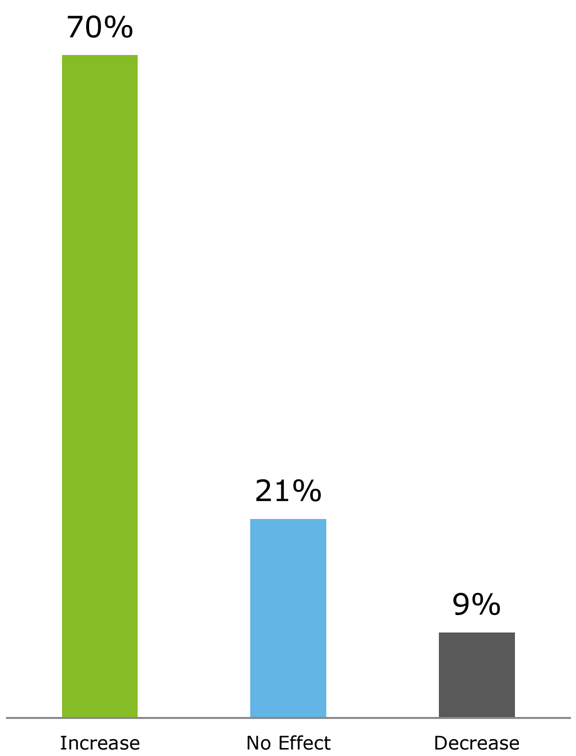
Top 5 investing industries, projects (2015)



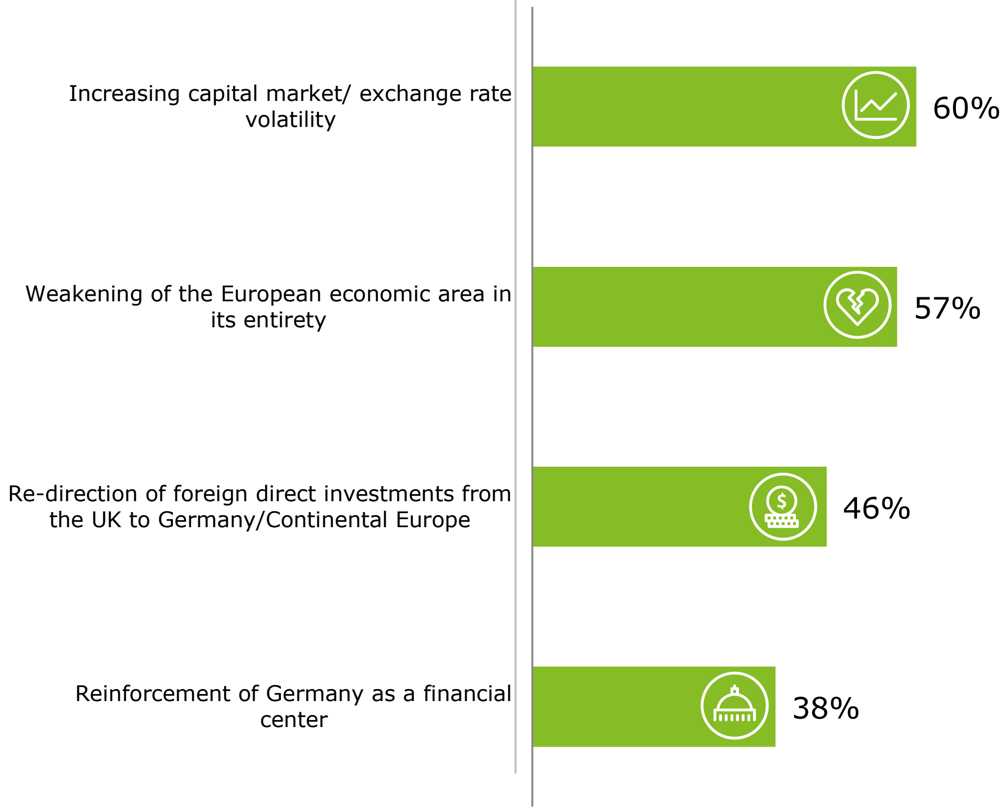
Foreign direct investment flows

Real estate experts expect higher demand for German property – and companies a re-direction of FDI flows

How will Brexit affect the German market for commercial property?



In the event of a Brexit how likely do you consider the following economic developments?



Source: Deloitte Expo Real survey, Deloitte/BDI survey

Foreign direct investment flows

The relative attractiveness of Europe for FDI will increase – changing investment dynamics possible in the long run

Continuing comparative advantages of the UK

- Deep capital markets
- Strong cluster in financial and other services
- Large international talent pool
- Time zone
- Language
- Legal system

What might change

- No direct access to the Single market, especially for tradable services
- Higher transaction costs to do business
- Shrinking international talent pool

LSE estimate: Loss of access to single market would lower FDI flows into the UK by 22 percent

EU/UK negotiations

Negotiations will at least last 2 years – but possibly much longer

Negotiation timetable

What we know

- Free movement of people will be key issue
- Trade negotiations usually last between five and ten years
- Huge administrative challenge
- Negotiation positions not consistent yet

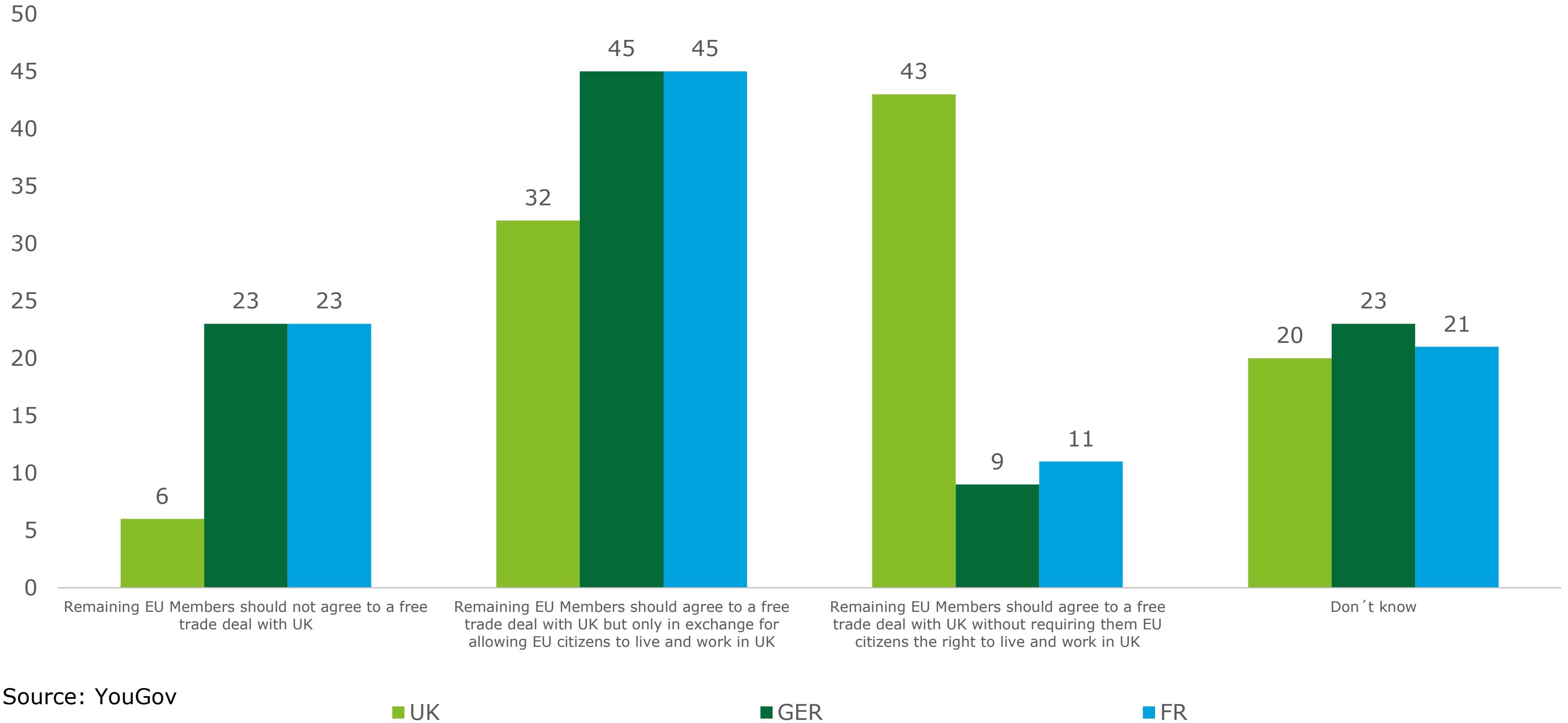
What we do not know

- Is extension of negotiations after two years realistic?
- How can an interim regime look like?
- Can the EU agree on a common position?
- How will the UK manage the trade-off between services trade and free movement of people?

EU/UK negotiations

European voters have strong views about conditions for a free trade agreement

It has been suggested that the next British government may seek a free trade deal with the European Union, but without any right for EU citizens to live and work in the United Kingdom.
Which of the following reflects your view?



Source: YouGov

EU/UK negotiations

To facilitate trade in services, a new kind of free trade agreement would be needed

		Free movement of EU nationals		UK controls on movement of EU nationals	
	**EU**	**EEA (Single Market)**	**EFTA**	**Free trade agreement**	**WTO MFN**
		Norway, Liechtenstein, Iceland	*Switzerland*	*Canada*	*Australia*
Controls on EU migration/free movement	✗	✗	✗	✓	✓
Free trade in goods	✓	✓	✓	✓	✗
Free trade in financial and professional services	✓	✓	✗	?	✗
		Soft Brexit		Hard Brexit	

- Regulatory convergence/mutual recognition/free movement vs. regulatory autonomy and migration control

Key takeaways

- German export industry likely to suffer – from lower growth in UK, from the depreciation of the pound and costs to reorganise supply chains

- Foreign direct investment flows will not change abruptly, but benefits and incentives to locate in Continental Europe will grow

- Free movement of people and services trade will be the crucial points in the UK/EU negotiations