



The economic consequences of Brexit for the Portuguese Economy and Companies

Executive Summary

Studying the consequences of Brexit requires the construction of simple scenarios that can identify the main lines of a new UK-EU relationship in the changing context of the European integration, as well as the rebalancing of power and functions between the developed and the emerging world.

Brexit is a **process of deconstruction of a long and deep economic integration** with relevant procedural difficulties, given the inexistence of similar experiences. Its consequences can be poorly evaluated, given the lack of knowledge about the real dimension of many of the transmission mechanisms of economic and social effects that are likely to materialize.

Since Brexit became a possibility several studies were conducted, both on the scenarios of the future UK-EU relationship and on the potential effects of Brexit in each of these scenarios.

Brexit will always be, in the short/medium term, a **loose/loose game and a process of asymmetric losses for the UK and the EU**. It will entail a significant increase in the level of uncertainty.

The exposure to the challenges of Brexit is **very asymmetrical**, when the UK and the EU27 are compared. The EU27 accounts for more than half of the UK imports (around 53%) and a slightly less than half of its exports (around 45%), while the UK accounts for only about 3% (0,5%) and 2,2% (0,6%), respectively, of the EU27 exports and imports of good (services). Consequently, the economic activity directly at risk, measured by the GDP associated to the exports, is four times higher in the UK (12%) than in the EU27 (3%), with special relevance for the services activities that account for around 40% of the UK total exports to its current EU partners.

CIP – Confederation of Portuguese Business decided to promote a study on the economic consequences of Brexit to **improve its own and its associates' capability in the preparation of the best responses to the challenges arising from this process**.

Most of the studies that were conducted place Portugal in the **second line of countries potentially most affected by Brexit**:

- Because of **its exposure to the UK**, since it is one of the countries where the relevance of the UK market is most relevant;
- Because it is **one of the most affected countries by the uncertainty** generated in this process (it is considered that the uncertainty caused by Brexit will have a greater impact on economies with a greater negative output gap, being Portugal in this situation);

- And because as a Cohesion net receiver of EU funds country it is among the countries potentially most affected by the **decrease in UK's contributions to the EU's budget**.

The analyses performed in this study involve an assessment of the **risks associates with the process but also the identification of opportunities for Portugal to benefit from Brexit**.

The two fundamental lines to assess the impact of Brexit are related to:

- The analysis of the effects on the Portuguese economy, resulting from the potential impact of Brexit in the **contraction of the British economy**; at this point, it is used the results of the main studies carried out for the UK economy to analyze the estimated macroeconomics effects resulting from the contraction of the UK economy in the demand and other economic flows directed to the Portuguese economy, with particular focus on exports, FDI, tourism and remittances from emigrants;
- The analysis of risks and opportunities for trade flows arising from the **change in the UK-EU economic relationship**; at this point, the risks and opportunities for bilateral flows of goods and services are assessed, using different approaches that seek to identify and quantify the various potential impacts.

The analysis performed in this study showed the **relevance of potential effects of Brexit for the Portuguese economy and companies, namely:**

- Resulting from the **expected contraction of the British economy** may occur:
 - ✓ Reductions in Portuguese **exports** to the UK between -1,1% and -4,5%
 - ✓ Reductions in **FDI** flows directed to Portugal between -0,5% and -1,9% and
 - ✓ Reductions in the **remittances from emigrants** between -0,8% and -3,2%
- The **change in UK/EU relationship** represents a strong risk to the Portuguese exports of goods and services, which may result in a potential **reduction in exports to UK between 15% and 26%**, depending on the type of future trade relationship that may be established.

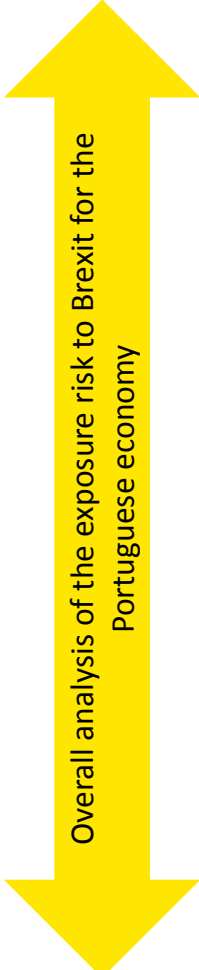
The risk assessment was also carried out at product/service level using several approaches using a four-level risk grid (see table). Most of the products that face a medium-high and high risk arising from Brexit are products for which the effect of a new future relationship between the UK and the various economies can be translated into the ability of other countries outside the EU to gain market share in relative terms in the UK, in detriment of the Portuguese exports.

Confronting the risk with the opportunities analysis it is interesting to note that for two of the products facing high or medium-high risk levels, there are simultaneously opportunities that can compensate those risk levels. In this situation are the Motor Vehicles and the Pharmaceutical Products, which may benefit from the loss of competitive position of British producers on the European market to replace them in that market, and thus offsetting part of the risks that they face in the British market.

For other products, which were classified as having high or medium-high risk by the aggregate results of the analyses, it is important to highlight that they have a protection due to historical presence than can mitigate the effects. The Furniture, the Machinery

and Equipment, the Rubber and Plastic articles and the Base Metals are the products in that situation. These products may exploit the opportunities associated with the new forms of segmentation and spatial distribution of the supply and value chains that will result from the reconfiguration of the European internal market as well as from the deepening of globalization to strengthen its presence in the UK or in the rest of the EU27.

Results of the overall sensitivity analysis of Portuguese exports to Brexit



High Risk	26: Computer, electronic and optical products 27: Electrical equipment 29: Motor vehicles, trailers and semi-trailers Travel*
Medium-High Risk	10: Food products 11: Beverages 12: Tobacco products 13: Textiles 14: Wearing apparel 15: Leather and related products 17: Paper and paper products 21: Basic pharmaceutical products and pharmaceutical preparations 22: Rubber and plastics products 23: Other non-metallic mineral products 24: Basic metals 25: Fabricated metal products, except machinery and equipment 28: Machinery and equipment n.e.c. 31: Furniture Financial Services*
Medium Risk	01: Products of agriculture, hunting and related services 07: Metal ores 08: Other mining and quarrying products 16: Wood, products of wood and cork, expt furniture; art.straw, plaiting materials 19: Coke and refined petroleum products 20: Chemicals and chemical products 30: Other transport equipment 32: Other manufactured goods 35: Electricity, gas, steam and air conditioning 38: Waste collection, treatment and disposal services; materials recovery services 58: Publishing services 59: Motion picture, video and television services, sound recording, music publishing 71: Architectural and engineering services; technical testing and analysis services 90: Creative, arts and entertainment services 91: Library, archive, museum and other cultural services Transport*
Low Risk	02: Products of forestry, logging and related services 03: Fish and other fishing products; aquaculture products; support services to fishing 05: Coal and lignite 18: Printing and recording services 74: Other professional, scientific and technical services

Notes: sectors are identified by their CPA code (Classification of products by activity), except those marked with * which correspond to groups of services, classified according to BPM6. The overall analysis for these groups of services does not consider all of the individual analysis performed in this study, due to methodological reasons (it was used only the potential impact of Brexit in the contraction of the British economy and the gravitational analysis); within each risk category, the sectors are displayed in ascending order of their CPA code

Risks and opportunities for the Portuguese economy and firms can be increased or reduced by several factors, being among them:

- A. the **historical ties** between the two countries;
- B. the large number of **Portuguese residents in the United Kingdom**;
- C. the **connection of Portuguese banks** to the United Kingdom;
- D. the implications in terms of **changes in macroeconomic governance in Europe**.

Except for the historical ties, with a clear positive effect, the effects of each of the other effects are unclear and depend on the dynamics of the deconstruction process.

- A. The **historical ties** have the potential to mitigate the worst consequences of Brexit, therefore they should be considered and enhanced,
- by allowing the exploration of opportunities to **replace the position of other EU27 member states in the UK market after Brexit** - the capacity to replace other countries as UK suppliers in the context of the reconfiguration of relationships, may not only reduce the risk of trade diversion but also enable the creation or reinforcement the flows to the United Kingdom.
 - by **affirming Portugal as the privileged partner of the United Kingdom in the EU27**; Portugal's affirmation as a UK partner in the EU may contribute to generating new FDI flows to Portugal from the United Kingdom, related to the location of British capital entities which need to have a presence in the EU, contributing also for the integration of Portuguese productive units into value chains located in the United Kingdom.
- B. Regarding the presence of a strong Portuguese community in the United Kingdom, this may contribute to maintaining a privileged relationship between the two countries, mitigating adverse effects in a context of a future closer relationship. But in a context of a “harder” Brexit, that involves a departure of immigrants from UK, the negative effects will be worse, given the amplification of impacts and the expected consequences, in aspects related to the rights of citizens with economic relevance (eg, work, income, tourism, property, taxation ...).
- C. The linkage of the Portuguese banking and financial sector to the UK can also help exploit investment and interaction opportunities, in a context of a future closer relationship. But it may be an additional weakness in a context of a “harder” Brexit, which may weaken the situation of the Portuguese financial sector, damaging the financing conditions of the companies and, by this way, influencing their capacity for internationalization.
- D. At last, the impact of Brexit can be mitigated or amplified depending on the effects that Brexit will have on the changes of Europe's macroeconomic governance and on changes in the financing conditions and the guidelines for the European cohesion and convergence policies. The United Kingdom took a particular position throughout the whole involvement in the process of European integration, excluding itself from various dimensions of this process, such as the Economic and Monetary Union or Schengen, and having a greater focus on the internal market dimensions of the EU than on the others. UK was, however, despite the circumstances of its involvement in the EU, an important net contributor and an element which contributed for some balance in many EU's positions. The reduction of the EU's budget, that will tend to result from Brexit as well as the possible changes in the European policy framework have the potential to significantly amplify the risk to Portugal.

Regional impact of Brexit

In terms of regional impact, the regions that, due to their specialization, face the greatest risks arising from the impact of Brexit at the **trade of goods** level are Alto Minho, Cávado, Ave and Tâmega e Sousa. Terras de Trás os Montes, Metropolitan Area of Porto and Beiras e Serra da Estrela are also identified as having a high level of risk.

At the **trade of services** level, the Metropolitan Area of Lisbon, Algarve and Madeira are the regions with the greatest risk exposure. The Metropolitan Area of Porto and the Region of Coimbra are also identified as having a high and a medium level of risk, respectively.

Conclusions and Recommendations

Systematizing, the Study allowed, in global terms, to stabilize four conclusive lines about the dimension and the expected relevance of the impact of Brexit for the Portuguese economy and companies and four lines of recommendations for the mitigation of these impacts.

In terms of conclusions, the Study makes it possible to highlight that:

- Brexit will be an **asymmetric process** between the United Kingdom and the European Union, as well as within the 27 long-term partners, that will last a long time, both in the negotiations involved and in the respective consequences and impacts;
- The impact of Brexit on the Portuguese economy is significantly **transverse**: in goods and services, in international trade and investment, in migration flows and in the remittances from migrants, in tourism and in real estate;
- The final configuration of the **future UK-EU trade relationship after Brexit is important in setting expectations of greater or lesser sensitivity of the Portuguese economy to the risks and opportunities** arising from the exposure to Brexit. This sensitive context is reinforced by the financial dimension of Brexit (with the expected decrease in funds allocated to Portugal as a result of the departure of the UK from the group of net contributing countries to the European Community's budget) and by the implications that the new EU economic governance framework may bring to Portugal;
- The **qualitative impact** of Brexit should not be underestimated. In addition to the direct quantitative effects estimated in this Study, qualitative impacts are likely to result from the various transformations inherent to the international turbulence in the redefinition of the positioning of various countries in the world economy, from the reflexes in the international movements of people, tourists, workers, residents, investment flows; from the changes of spatial distribution of the globalized design, production and distribution of goods and services chains, and to the forms of transnational business relationship.

Regarding **recommendations**, the results achieved justify four lines of recommendations, combining risk mitigation with the enhancement of opportunities.

The actions and initiatives to be taken by Portugal and by the Portuguese companies are framed in objectives that aim to offer a set of priorities and contents to address the diagnosis of the threats and opportunities resulting from Brexit for the Portuguese economy:

- to be proactive in **valuing the United Kingdom as a Portugal's economic partner**
- to be proactive in **bringing Portugal closer to the Anglo-Saxon matrix** of business strategy and practice;
- to attribute strategic valuation to clear objectives for the **diversification of Portugal's economic relationship**;
- to anticipate an **approach that is necessarily aware of the asymmetries in the impact** of Brexit, both in terms of activities/**sectors** and in **regional** terms.

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