BMI Research
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Industry Trend Analysis - Brexit Implications: First Thoughts On Industry Impact

24 Jun 2016 | United Kingdom | Infrastructure

In our recent analysis of key risks in the event of a Brexit vote, we identified four broad categories of implications that will impact industries in the UK (*see 'Brexit Implications: Industry Impact For UK And Europe, June 3*). These have now moved from risks to core scenarios, and we reiterate that we expect investment delays, shifting cost bases, export and trade disruption, and public funding cuts to impact a range of industries to varying degrees.

In the series of industry analyses in this special report we examine immediate and possible longer-term implications, risks and opportunities for UK and European industry segments following the vote for Britain to leave the European Union.

Investment Delays

We anticipate a major hit on gross fixed capital formation in the UK as reduced investment and delays in investment decisions become the norm while a renegotiation takes place. This will have a particular impact on the construction and infrastructure sectors, while other industrial manufacturers will witness a decrease in orders as businesses hold off from investing in new capital until the demand outlook stabilises.

Shifting Cost Bases

Lower migration, currency volatility and depreciation, and new regulations are the three transmission mechanisms for shifting cost bases.

Lower migration would translate into higher wage costs for employers, with the largest impact on labour-intensive industries, especially agriculture, retail, construction and the hospitality sector.

FX volatility would see business costs rise on average, especially for industries with a significant non-sterling cost base such as retail, autos and airlines.

Export And Trade Disruption

The net impact on trade per industry comes down to which of the following two factors is more important for that industry:

- Generally more competitive exports due to a weaker sterling, which would be trade positive with the world.
- Potentially higher duties and/or red tape applied to UK imports into the EU, which would be trade negative.

Beyond two years, as the UK restructures its ties to the EU markets, a lot will depend on how successfully it gains access to faster growing markets outside the EU.

Public Funding Cuts

The allocation of funding per industry may differ under a solely UK-managed funding system compared with under the current UK-EU system.

The withdrawal of the Common Agricultural Policy subsidies will have a major negative impact on the UK agriculture sector, and it is highly unlikely the UK government will be able or willing to fully plug that gap.

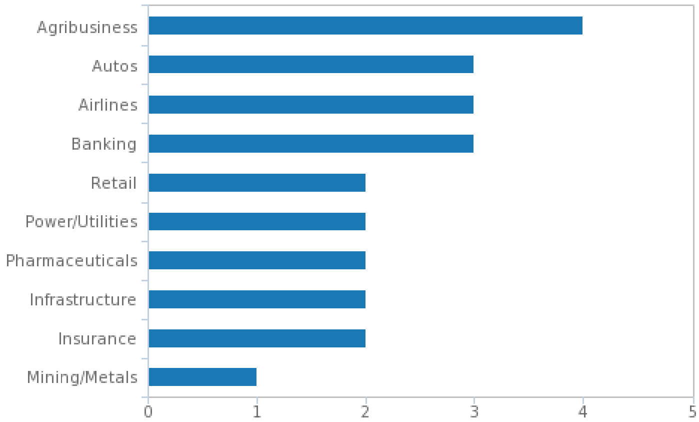
The UK pharmaceutical industry receives more funding from the European Research Council than any other European nation. Brexit could threaten the EUR10.8bn (USD12.0bn) allocated by the EU towards UK science over the next four years.

Varying Degrees Of Impact on Industries

In our matrix of the magnitude of the impact a Brexit would have on industries (*see chart below*) we identified agriculture as the most exposed and mining and metals as the least. The knee-jerk reaction reflected in the stock market reinforces our view of which industries will bear the brunt of negative implications of the UK's exit from the EU, such as airlines, homebuilders, financial services, agribusiness and autos.

Ranking Brexit Impact

Select UK Industries - Negative Impact Under Brexit Scenario

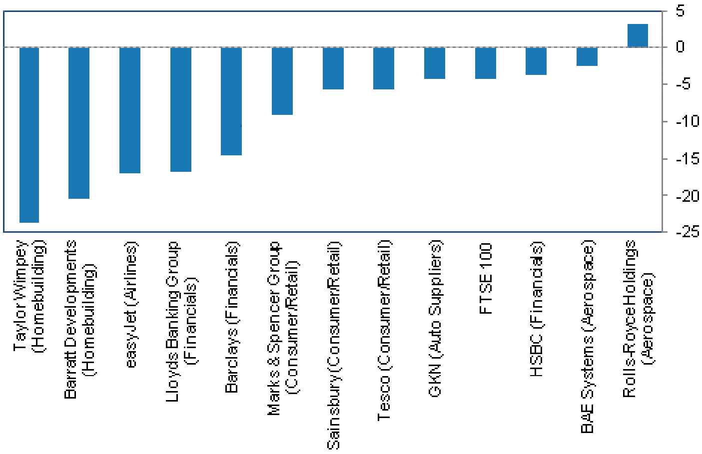


Note: 4 = high negative impact, 0 = no impact. Source: BMI

At time of writing, homebuilders, airlines and financial equities are most heavily impacted, reflecting the uncertain outlook for these sectors. We believe the City of London will most likely maintain its status as a global financial sector, but its importance will most likely diminish outside the EU.

Airlines, Financials And Homebuilders

% Change In Equity Prices, FTSE



**T he percentage change is between the closing price on June 23 and 9:30am UK time on June 24. Source: Bloomberg, BMI*

While a long renegotiation lies ahead and everything will depend on the exact terms of the exit deal, the lingering uncertainty will be the main immediate impact. Homebuilders will certainly feel this, and we anticipate a major drag on UK construction in the coming months.

For industries that rely on trade (agriculture, auto suppliers and manufacturers and retailers being at the forefront), the prospects for tariffs and changes to the supply chain are the main risks.

Scottish Referendum Key Risk To North Sea Outlook

A second Scottish independence referendum is now firmly on the cards. This will significantly increase uncertainty surrounding the UK North Sea, where the bulk of UK production is concentrated. Hence, this is the biggest risk for the UK oil and gas sector.

Investment in recent years has been sluggish due to inflated operating costs and maturing basins. Concerns over the direction of fiscal and regulatory policy under an independent Scotland will further compound this trend. The division of North Sea assets is another area of uncertainty, and an existing maritime boundary dispute between England and Scotland raises jurisdictional question marks over a number of fields. A further pullback in investment would be a strong bearish indicator for longer-term production growth.