MANUFACTURING A BETTER FUTURE?

Brexit and the industrials sector

Months of campaigning are nearing the final stages before British voters go to the polls to decide if the UK should remain in or leave the European Union. Historically, the UK has been marginally favourable towards EU membership but the most recent polls suggest a shift in opinion, with the 'Vote Leave' campaign gaining the edge. This has tipped sterling volatility to its highest level in more than seven years, a clear sign of market anxiety preceding the vote – and it is likely to become even more volatile, particularly if polls closer to 23 June show an even greater margin for the 'Leave' camp.

Managing the risk

According to a recent Deloitte poll, 83% of CFOs think, "the level of uncertainty facing their business is above normal, high, or very high." This is up from 64% in the last quarter and is at the highest level since Q4 2012. Despite the assumption that many businesses will have thoroughly assessed the risk and planned their Brexit strategy, the same Deloitte poll shows that a significant number of businesses are underprepared for a potential Brexit and some have deliberately steered away from contingency plans. Harald Krueger, the CEO at BMW, told the company's annual meeting that "there is no point speculating about a Plan B" and that should the UK leave the EU, BMW will use the ensuing two-year transition to decide next steps.

Equally, data from the Markit/CIPS survey shows that whilst 35% of businesses said that a potential Brexit was having a strongly detrimental or detrimental impact on income, 51% said it was having no significant effect. Somewhat surprisingly, Lord Bamford, Chairman of JCB Excavators Ltd is one of the few global businesses in the sector to publicly speak out in favour of a Brexit, telling employees and JCB pensioners that "JCB and the UK can prosper just as much outside the EU, so there is very little to fear if we do choose to leave."

Short term currency volatility

However, as the spectre of a 'Leave' vote hangs over the FX markets, many corporates will be looking at hedging options to protect assets against currency volatility. However, some trading firms are trying to stop customers making risky trades in the run-up to the referendum in a bid to minimise exposure and reduce volatility in the market following the result.

Firms are planning to limit the amount of leverage offered to customers and increase margin rates in a bid to put a dampener on trading activity, limiting the potential for losses for both customers and businesses in the event of big market swings.

Many businesses are implementing 'no trade windows' in the latter part of June to mitigate the potentially adverse impact from Brexit. In practice, this means that businesses will not undertake FX trades involving sterling (or engage in related commercial trading) due to potential volatility, and will also delay settlement of relevant trades until the window is closed.

Is the industrials sector particularly vulnerable?

According to an article in the *Financial Times,* manufacturing (auto and other), food production and chemicals would be the principal areas within the industrials sector which are exposed by trade, migration and investment challenges respectively in the event of a Brexit. However, given the substantial trade links existing, Richard Morawetz, an analyst at Moody's says, "those sectors that are most exposed to a Brexit are also those where there would be the greatest effort to seek an alternative." So we can assume that those industries would move forward and adapt quickly.

Currency volatility

As soon as Boris Johnson announced his intention to campaign for a Brexit back in February, the value of sterling dropped. Given many industrials businesses are significant importers and exporters, their costs will have risen overnight, making it unsurprising that industrial output was down to its lowest levels since 2013 in Q1 of 2016. There has been little respite since, and IMF chief Christine Lagarde has warned that Brexit could wipe 20% off the value of Sterling, which could remain weak whilst consultations progress and a new model is established. For any business, trying to operate effectively through years of uncertainty brings significant challenges, particularly those so heavily reliant on international markets.

Tariffs

Depending which poll you read and which Brexit model you look at, if the UK leaves the EU it may be subject to significant tariffs on goods and services going into or out of the EU. If it were to join the European Economic Area, like Norway, it may avoid tariffs, but until we know more about the specific Brexit model the UK would adopt, the possibility of tariffs remains an unwelcome prospect for many industrials businesses, particularly the automotive sector which exports more than half its cars to the EU each year and relies significantly on an international supply chain. However trade analysts at S&P argue that the sector would be able to adapt or reduce the impact: "carmaking is a global industry and most manufacturers control factories in more than one country, have ongoing co-operation agreements and joint ventures with other players, and benefit from a truly international supply chain."

Recruitment

Many businesses in the industrials sector rely on unskilled labour from other countries in the EU to fill roles such as warehouse staff, production line workers and drivers, amongst others. If the UK left the EU, again, depending on the model of its ongoing relationship with the EU, it may no longer be party to the free movement of people obligations, making it much harder to recruit foreign workers for these crucial but often undervalued roles. Conversely, some argue that this would create more opportunities for UK job seekers.

Agriculture and food

The common agricultural policy, or CAP, is often held up as a totem for all that is wrong with the EU, with its overbearing complexity and bureaucracy. Opinions are polarised on whether the UK would save significant sums of money by leaving CAP, or whether it would, in fact, be detrimental to British farmers. The UK is a significant importer of food, so if we were to leave CAP, we would need to find another framework for collaborating with the EU.

Health and safety

Many political commentators and business leaders view a Brexit as a chance to regain control of Health and Safety legislation which has been predominantly driven by EU decision makers. EU legislation permeates our workplaces, creating a perception of red tape which many organisations would gladly leave behind – although we cannot ignore the well established, positive legislative instruments stemming directly from EU decision making. In the event of a Brexit, untangling EU and UK law would present a challenge and has the potential to result in mixed consequences for the UK. Brexit campaigners should note that even if the UK exited the EU, there would still be external pressure to maintain certain standards for the benefit of trade agreements, potentially via other world players (such as the IMF or WTO), or via target markets. In short, in the event of Brexit standards won't diminish, even if some of the regulations can be done away with. A Brexit would likely only result, in respect of health and safety law, in lip-service to removal of red tape. The law in this area would likely remain, largely, the same.