PRESS RELEASE

Brexit: Despite several shocks, the United Kingdom will remain attractive for businesses

- **Businesses have proven their resilience since the referendum, but a downturn in investments is starting to be seen**
- **The fall in growth (1.4% in 2017 and 1.2% in 2018) will lead to a rise in the number of business failures, of 8.7%[1] and 8%[1] respectively**
- **A decline in migratory flows with the EU is forecast to have a negative impact on the United Kingdom's growth - of 0.3 pts for a "soft Brexit" and up to 0.6 pts for a "hard Brexit"**
- **Businesses may become less attractive, but the country will still offer significant advantages in the eyes of investors**

Despite the UK economy's resilience, a wait-and-see attitude will develop among businesses and intensify during the negotiations phase

One year on from the vote to leave the EU, UK businesses are showing resilience, bolstered by household consumption (up 2.6% in 2016), favourable credit conditions and strong worldwide demand. In the last quarter of 2016, companies' profits totalled over 105 billion pounds sterling - an all-time high. Confidence rose significantly, especially amongst SMEs, after an initial fall in the aftermath of the referendum. Sterling's sharp drop, which is the most visible sign of the looming Brexit, explains the strength of exports, even if the benefits of price competitiveness remain slight.

Despite favourable economic conditions and high profits for businesses, uncertainties over the outcome of negotiations between the UK and the EU are already causing a decline in investments (8.8% of GDP in 2016, the lowest since the economic crisis). This is expected to intensify in the run-up to April 2019. Sectors where investments are the costliest, such as metalworking, automotive and construction, are likely to be the hardest-hit.

This negotiation phase will test the current buoyancy of businesses. As of 2017, the slowdown in household consumption, due to increasing inflationary pressures, will weaken the retail sector (downgraded by Coface from "medium" to "high" risk in March 2017). It will also put pressure on the automotive sector, although to a lower extent, as it will be bolstered by foreign demand. In addition, business profits are expected to show a gradual decline, given the rise in costs caused by the exchange rate depreciation. Within this context, Coface estimates that UK business failures could rise by 8.7%[1] in 2017 and 8%[1] in 2018, largely due to the decline in growth, which could reach 1.4% in 2017 and 1.2% in 2018.

[1] These estimates were produced by adjusting the model for the exceptional rise in business failures that occurred in the last quarter of 2016, due to a regulatory change (1,796 cases). Without this adjustment, business failures would have fallen by 2.7% in 2017 and risen by 8.8% in 2018.

Confronted by declining attractiveness and more restrictive trade and migration policies, UK businesses will need to adapt to a new playing field

When the United Kingdom leaves the European Union in spring 2019, the protectionist shock will have a significant impact on trade policy. This will be especially so if there is a hard Brexit (with a return to WTO rules), due to increases in tariff and non-tariff barriers. According to the OECD, the loss in GDP by 2030 could therefore be around 7.5%, vs. 5% for a soft Brexit.

The trade shock could be accompanied by labour shortages in some sectors, following the introduction of a restrictive immigration policy. In the case of a soft Brexit (the leading scenario for Coface), a one-third drop in European migration inflows could result in a potential growth loss of 0.3 GDP points in 2019 - almost as great as for the protectionist shock in a similar scenario. This loss could rise to 0.6 pts in the extreme scenario, with a steep fall in net immigration of two-thirds. Sectors that employ large numbers of qualified immigrants from the European Union - such as the manufacturing, wholesale and retail trade, transport, communications and financial services - will be the hardest-hit.

Regardless of whether Brexit is soft or hard, the country's attractiveness for investors will certainly be affected, with foreign direct investments (FDI) falling by 22%[2]. The United Kingdom is currently the main European destination for FDI, primarily into the financial, information and communications sectors, followed by transport and logistics. Brexit signifies a negative impact on business investment and the accumulation of capital stock, with consequent reductions in innovation and R&D.

UK businesses, which have two years to prepare for leaving the European Union, will have to adjust their strategies. Some of the more fragile and smaller businesses may disappear - or have to transform their business models to become more resilient. Others may need to adjust their sectoral and geographic strategies, by relocating to Germany, France, Ireland, or the Netherlands. Nevertheless, Brexit does not completely negate the structural attractiveness of the United Kingdom, which will retain most of its advantages. These business benefits include transparency, good governance, a business-friendly ecosystem and a diversified, flexible labour market. Brexit will not negate the UK’s attractive tax system either, and in fact it should become even more appealing, with the tax rate set to fall from 20% at the beginning of 2017, to 17% in 2020).

[2] According to the study by R. Bruno, N. Campos, S. Estrin and M. Tian, "Gravitating towards Europe: An Econometric Analysis of the FDI Effects of EU Membership", 2016

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