Creditreform Rating

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Germany with moderate direct exposure to Brexit risks

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The countdown is on. On 29 March 2019, the United Kingdom (UK) will leave the European Union (EU). Whether the British government and the EU will manage to regulate their future relations contractually by then, or whether it will come to a disorderly, so-called "hard" Brexit, seems more uncertain than ever at the moment. There are already signs that the prolonged uncertainty about the further progress of the Brexit negotiations is noticeably slowing economic growth in the UK.

It is undisputed that the British economy would suffer even more severely in the event of a hard Brexit than it has done so far. But what effects would the remaining EU member states have to expect in this case? Creditreform Rating has investigated this question in an analysis to be published shortly on www.countryrisk.de. In order to determine which countries would be most affected by a hard Brexit, the European rating agency has developed the Brexit Risk Indicator (BRI), which takes into account four risk dimensions: direct investment, exports, the financial sector and migration.

Overall, the Irish economy would be hardest hit by a hard Brexit. A look at the individual risk indicators shows that Ireland is most exposed to migration and trade among the remaining 27 EU Member States. The situation is similar for exports of goods and services. Like the real economy, the Irish financial sector has a significant UK exposure. At the end of 2017, Irish financial institutions recorded the second-highest exposure to British banks in the EU-27.

Geographical proximity alone, however, is not a sufficient criterion for an above-average Brexit exposure. For example, Cyprus and Malta are exposed to the second and third highest Brexit risks respectively. In both economies, the financial sector and tourism play an important role. In both Cyprus and Malta, the British represented the largest group of foreign visitors in 2017, which is ultimately reflected in the export balance. Moreover, in the case of Cyprus in particular, there are close financial links with the United Kingdom.

In terms of investment and financial sector exposure, Cyprus ranks third in the EU. Only the Netherlands and Luxembourg, ranked fourth and fifth respectively in the risk ranking, hold more investment assets in the UK. This is partly due to the corporate policies of multinationals. Finally, Luxembourg and the Netherlands are among the preferred locations for financial special purpose vehicles within the EU.

Thus, there are comparatively many small countries at the top of the risk index. In the absence of a large and stable domestic market, many small economies have a high degree of openness to trade and financial flows - but as a result, external vulnerability increases. Among the EU's major economies, France faces the highest risks. The German economy ranks twelfth.

Brexit risks appear relatively moderate in large parts of Central and Eastern Europe. This may be explained by the fact that most CEE countries have only little trade and financial ties with the UK. Since most Eastern European countries are transition economies, it is also not surprising that the private sector of these countries does not yet hold significant direct investments in the UK. Indirectly, the Eastern European countries would be most likely to be affected by a restriction or suspension of the free movement of workers.

Creditreform's analysts stress that their risk indicator gives a rough indication of the potential economic impact of the Brexit by highlighting different risk dimensions and revealing country-specific vulnerabilities. Indirect effects are excluded as they are associated with an even higher degree of uncertainty. Germany in particular, with its very pronounced economic relations, would probably be particularly affected here. The underlying economic strength in the countries is also not taken into account. Countries such as Italy could experience economic turbulences in the event of a hard Brexit, even if the BRI here may be not as high.

The authors also stress that a disorderly Brexit has become more probable after the British Parliament's rejection of the draft treaty negotiated by Prime Minister May and the EU Commission - but this is not their baseline scenario. Instead, Creditreform Rating currently expects a delayed Brexit deal between the UK and the EU.