Covid-19 plus Brexit equals uncertain 2021

A disorderly end to the Brexit transition period would cause significant disruption next year.

Michael Neary, Corporate Finance Partner, Grant Thornton, assesses the economic outlook for Ireland and the Motor Industry in the year ahead, identifying opportunities and challenges amid the fog of uncertainty.

The Motor Industry is cyclical in nature, both vulnerable to, and benefiting from, economic cycles. Therefore, it is important for the Industry to consider the wider economy of Ireland when planning. The impact of economic cycles can have significant and long term impacts on businesses.

The European Commission expects Ireland to be one of the best performers in the EU this year, albeit activity will shrink due to the impact of the Covid-19 pandemic.

The outlook for Ireland in 2021 will depend on the severity of Covid-19 and the resulting lockdowns which are difficult to predict as the viability of a widespread vaccine is still unknown. Initial results from vaccines are promising; however, there are still a number of issues that need to be determined.

Dept of Finance projections

The Department of Finance's Budget for 2021 has forecasted that both Covid-19 and a Brexit without an agreement will have a significant impact on the Irish economy. The Department of Finance has prepared its macroeconomic projections based, firstly, on a Hard Brexit, (i.e. no agreement will be reached and bilateral trade between the UK and the EU will be on World Trade Organisation terms) and secondly, on a widespread vaccination for Covid-19 not being available.

The Department of Finance projects that GDP will fall by 2.5% in 2020 before growing by only 1.4% in 2021. While the impact of Covid-19 on GDP is less than previously expected, this reflects the contribution to GDP from parts of the multinational sector, particularly the resilience of multinational companies that dominate exports.

However, the hit to the domestic economy has been severe. Modified domestic demand, perhaps the best indicator of domestic economic conditions, is projected to fall by 6.5% this year followed by a 3.9% increase in 2021.

The labour market entered 2020 in a healthy condition; however, at the height of the lockdown 20% of the workforce could not work and some have still not been able to return to work. The Department of Finance projects employment to fall by 13.8% this year with an annual average unemployment rate of just under 16% this year, and 10.7 per cent in 2021. Employment has been shielded by state income support

While there is positive recent news around vaccines, the Dept of Finance's projections have been based on the assumption that a vaccine will not be widely available in 2021 and the European Commission assuming that "virus containment measures will remain to some degree in force throughout the forecast horizon", it would be prudent for Motor Dealers to do the same.

schemes that will continue into 2021 but nonetheless, levels of disposable income may still be impacted. This is likely to affect car sales.

Tough challenge

There is no doubt 2020 has presented a tough challenge for automotive manufacturers, retailers and the wider supply chain. New registrations for the first 10 months of the year to October were down 25% when compared with the same period last year. The worst affected months were March, April and May at the height of the lockdown with new registrations falling by 64%, 96% and 72% respectively compared to the same months in 2019.

Recently, new registrations have been healthier with new registrations of 5,651 in September and 2,296 in October, an increase of 65% and 5% respectively on the same month in 2019. The 2020 estimated new car market before Covid-19 was roughly 100,000, now it is predicted that 85,000 units will be sold in 2020. This is a 42% decline when compared to 2016 where 146,650 units were sold.

When the pandemic hit earlier this year, Dealerships were forced to close for roughly two months but despite the poor figures for new sales, clients in the Industry are cautiously optimistic for the future as the used car market has been doing well over the last couple of months. Some consumers have found themselves with more disposable income, as they have not been on holiday or had to pay to commute.

With the return to work, people have also looked to avoid public transport due to the risk of infection and this has increased the demand for new and used vehicles.

It is difficult to predict how Covid-19 will impact trading in the year ahead but, with the Department of Finance assuming a vaccine will not be widely available in 2021 and the European Commission assuming that "virus containment measures will remain to some degree in force throughout the forecast horizon", it would be prudent for Motor Dealers to do the same.

Implications of Brexit

High levels of sales taxation in Ireland have meant that new cars have been more expensive in Ireland than many other countries. Ireland currently has the second highest levels of sales taxation in the EU (Denmark having the highest). The high levels of taxation on both new and used cars force consumers to seek more affordable alternatives – which in recent years has resulted in cheaper used cars being sourced from other markets.

The initial impact on the Irish Motor Trade of the UK's decision to leave the EU was largely currency-related; the weakening of Sterling as a result of the decision to leave made used car imports from the UK significantly cheaper. This resulted in the number of used car imports increasing from 47,774 in 2015 to 113,926 in 2019, a 138% increase over four years. The availability of a supply of lower-cost used cars put pressure on the prices of used car values and had a knock-on effect on new car sales with the number of new registrations dropping consistently since the UK voted to leave the EU in June 2016.

Under the assumption of a disorderly end to the transition period, there is likely to be significant disruption to trade next year. The Department of Finance projects GDP to grow by around three percentage points less than it otherwise would if a Free Trade Agreement was put in place.

A consequence of having the second highest new car taxation levels in the EU is that not enough new cars can be sold to create an adequate secondhand market that will satisfy consumer demand. This lack of supply is being met currently by used cars imported from the UK.

When the UK leaves in January, it is difficult to predict if this supply will be interrupted or even still be economically viable. With the deadline fast approaching and no deal in sight at the time of writing, it is looking more likely that there will be no deal.

Key questions

The Irish Car Carbon Reduction Alliance report (dated September 2020) noted two main questions that need to be answered:

1. **Will the EU VAT 7th Directive apply to imported used cars on January 1, 2021?**
   If it doesn't, then we revert to the position pre-1995 when used cars imported from the UK became unaffordable because of double VAT.
2. **Will a tariff of 10% be added to imported cars from the UK?**
   If it is, then this will also have a severely limiting effect on the supply of used cars coming from the UK.

In summary, over the next 12 months, the various contingencies bring with them potential benefits and possible threats. Despite the challenges ahead, many Dealers are optimistic – the takeaway message is to financially plan on a prudent basis, which expects the worst, while positioning yourself to fully take advantage of any economic upswings and opportunities that may arise.