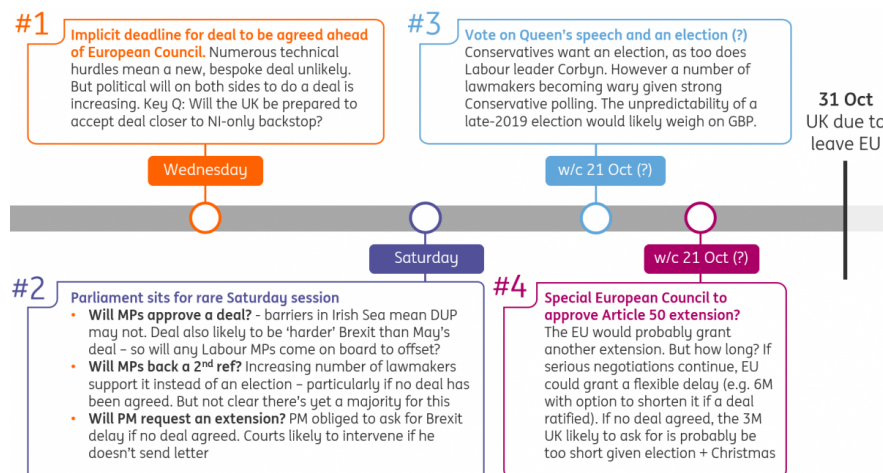


Brexit and the uphill battle for a deal this week

The chances of a Brexit deal have undoubtedly risen over recent days. But as the clock counts down to Thursday's European Council, political optimism is slowly colliding with technical reality. There are a number of hurdles to overcome in a very short space of time, and we suspect the odds are still stacked against a deal being agreed and approved this week

This week's key Brexit dates



Source: ING

The UK has moved on the thorny issue of customs

The British pound has been on a rollercoaster ride over the past few days, as a surprising bout of political optimism about a Brexit deal has slowly collided with technical reality. But things are moving fast - and it's worth recapping what we know so far.

First off, we know that the UK has shifted its position on the Irish backstop. Up until now, there has been a deep divide on the topic of customs. And this proved fairly binary - the UK wanted Northern Ireland (NI) out of the EU's customs regime, to be able to benefit from non-EU trade deals. Brussels' has failed to see how this ambition can be squared with a commitment to avoid a hard border.

But over the weekend, the UK [reportedly](#) pushed the idea of a 'customs partnership'. Under this model, goods headed across the Irish Sea from Great Britain would pay the EU's tariff. Should the

consignment ultimately be sold in Northern Ireland, then the seller would be eligible for a refund. The implication is that there would be no customs checks between Ireland and NI – but the rebate system would give NI the opportunity to participate in any future global trade deals the UK strikes.

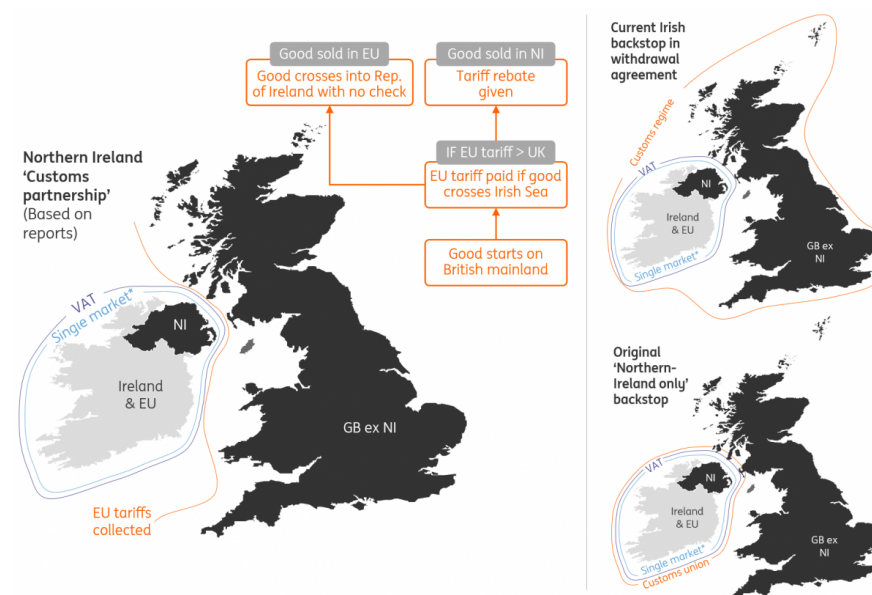
Barnier wasn't convinced by the UK's 'customs partnership' plan

As a weekend of talks came to a close, however, it became evident that the EU's Chief Negotiator Michel Barnier wasn't a fan. A deal of this kind would be a gamble for the EU – for three main reasons:

1. How would it work in practice? There would be logistical challenges in getting it up and running, and this comes back to many of the debates that have repeatedly cropped up – does the technology exist? Would trusted-trader schemes work, given the increased incentive to smuggle? Is it legally operable?
2. Time. In theory none of these practical considerations are insurmountable. But with a matter of hours of negotiating time left, there simply isn't the time to thrash out many of these concerns.
3. Westminster. Many commentators have pointed out – quite validly – that the EU made similar arguments about the Irish backstop at the same time last year. But as talks came to a close, it offered London a fairly sizable compromise in the form of an all-UK customs union. Crucially though, the compromise didn't pay off – the agreement was still rejected three times in Westminster.

Is this time different? Maybe – we'll come onto that in a minute – but without certainty that the numbers exist in Parliament, the EU will be reluctant to offer a major change.

Irish backstop proposals compared



Source: ING, Various

Note: The 'customs partnership' plan has not been officially unveiled by the UK, so this diagram is largely based on press reports

Finding another landing zone will be tricky in such a short space of time

If it's a 'no' to the UK's 'customs partnership plan', then is there another landing zone that is reachable before Thursday's European Council meeting?

Various reports over the past few days suggest Brussels wants to push the UK back towards an off-the-shelf solution.

There's long been talk about the so-called 'Northern-Ireland backstop' – a solution whereby NI stays in a customs union with the EU, along with the single market for goods. From the EU's perspective, this is much more legally-sound – after all, it was its original proposal for the Irish border way back when. But Johnson has long been adamant that this is not an acceptable solution, and he would almost certainly lose the DUP in the process.

It's hard to see a new, bespoke deal being struck in time for the European Council

Is there something in between? Nobody knows for sure what's going on behind closed doors, but there is [talk today](#) that the UK may be pushing for a partial free-trade agreement to be agreed upfront. The theory is that many of the 'customs partnership' concerns could be alleviated if tariffs on goods crossing the Irish Sea are predominantly set at zero.

However, Brussels will be reluctant to go down this route right now. The EU has always insisted that talks on the divorce (withdrawal agreement) should be tied up before moving on to the future arrangement.

Don't forget too that the future trading relationship will take on a number of other EU priorities beyond concerns about the Irish border. Different countries have different sector-specific priorities, as well as political ones (e.g. Gibraltar). Talks will also be complicated by the UK's signal that it no longer wants to maintain a "level-playing field" with the EU – which could see changes to workers' rights, environmental regulations etc – which will likely limit the scope of a future trade agreement.

How will the government play out the coming days of talks?

In short, it's hard to see a new, bespoke deal being struck in time for the European Council.

Having said that, the last week has shown just how keen PM Johnson is to agree a deal. An election is almost certainly on the way, and a Brexit deal could help propel the Conservatives towards a majority.

That leaves us with a couple of possible scenarios.

Faced with the imminent prospect of being legally-bound to ask for an Article 50 extension, the prime minister may decide to take a gamble and put something that closely resembles a NI-only backstop to Parliament when it meets on Saturday.

Parliamentary approval will be pretty difficult

That would almost certainly risk losing the DUP, but the PM may calculate that he can win support from elsewhere. A handful of Labour MPs have previously signalled they regret not voting for Theresa May's deal. But without the all-UK customs union, and workers/environmental commitments, would they be prepared to back *any* deal – particularly if signing up to it offers Johnson an opportunity to secure a larger majority in a general election?

As always, there's also the question of how pro-Brexit Conservatives would react. Many are likely to remain sceptical of the deal – particularly if the DUP does not support it. But then again, many of those that voted against May's deal initially are now part of the government, meaning they themselves are more invested in the process than before.

In other words, Parliamentary approval will be pretty difficult, albeit certainly not impossible.

Alternative scenario: The PM drags things out 'til the end of October

Without certainty over how things will play out in Westminster, the PM might instead decide that there's merit in trying to keep talks going through the rest of October.

The 'Benn bill' would oblige the prime minister to reluctantly request an Article 50 extension this weekend. In those circumstances, the EU could offer another flexible extension – perhaps one that lasts for around six months, but that could be cut short if a deal is ratified.

That would be embarrassing for Number 10, but Johnson might calculate that it's worth risking if those extra two weeks could yield a more palatable deal.

Success would mean he can still claim to have “done Brexit” by the end of October – although of course more time would be needed to pass all of the follow-up legislation, meaning the UK would more likely leave later than 31 October (this is probably also true even if a deal is approved by lawmakers this weekend).

In reality though, this scenario looks less likely. Two extra weeks is unlikely to move the needle very far in negotiations – and even if it did, there's no guarantee the Parliamentary maths would change. [The Sun](#) also reports that Downing Street is still very wary of being forced to seek another extension.

Whatever happens then, another Article 50 extension looks likely – whether that is to allow time to get a deal over the line, or more likely, to facilitate a general election in December.

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