

Brexit: Back to Brussels... again...

Parliament has backed PM May's bid to reopen talks with the EU on the Irish border "backstop" plan, but with Europe publicly refusing to do so where does Brexit go from here?



Theresa May, UK Prime Minister

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A better day for the PM

Another tumultuous day in Brexit land concluded with Parliament voting in favour of sending Theresa May back to Brussels to get a "better" withdrawal deal. In another rare victory for the Prime Minister, amendments that would have given Parliament the power to delay Brexit (by extending Article 50) if a no deal Brexit appeared likely, were voted down.

The result is that in the coming days the Prime Minister will be seeking a "significant and legally binding change" on the Northern Ireland backstop that would prevent the UK being tied indefinitely to EU rules. New wording that facilitates this would then be put before the UK parliament with the expectation that this would pass and Brexit could proceed. But with the EU refusing to countenance a situation that could potentially lead to a "hard" Irish border, requiring customs and regulatory checks on goods and possibly passport checks for people, it will be challenging to say the very least.

The EU remains united

Optimists in the British government suggest that this is the public position of the EU and privately

there are hints of movement, but the EU has proved to be remarkably united so far and there is no reason for this to change just yet. Sabine Weyland, the deputy chief EU Brexit negotiator has been unequivocal, stating “we’re not going to reopen the agreement”. Moreover, there is the risk that if the EU were to agree to re-open discussions, they could actually come back with their own demands of concessions on other areas that the UK may need to make, such as fishing rights.

What next?

The next step is for Parliament to vote on what the PM returns with from Brussels by February 14. If the Prime Minister fails to get changes on the withdrawal agreement then this will again open up the possibility for amendments that offer the opportunity for altering the course of Brexit with Article 50 extensions and potential parliamentary votes on alternatives, such as a “softer” Norway style agreement or even a second referendum. However, the risk remains that politicians still haven’t coalesced around a plan of action for Brexit and the uncertainty continues. We also have to remember the EU needs to agree to it too. This uncertainty will ensure sterling continues to struggle in the coming days and weeks, business contingency plans intensify (diverting attention away from growth opportunities) and the prospect of any Bank of England monetary policy tightening further recedes.

Meet Malthouse

This is likely to mean that we hear a lot more about the so-called Malthouse compromise, which appears to be gaining traction in government circles. It brings together both Conservative Brexiteers and Remainers and is named after Kit Malthouse, the Brexit supporting Minister of State for Housing who has helped shape the proposal. It comes in two parts.

Part 1 states that if Theresa May can get a renegotiated Irish border backstop with an “acceptable indefinite solution” the UK will “maintain our offer on the rights of EU citizens... the agreed financial settlement” with extending the transitional arrangement (where the UK is effectively still within the Customs Union and Single Market) for an extra year to December 2021 from December 2020 as it currently stands.

The extension gives Britain and the EU more time to negotiate their future trading arrangements and implement the infrastructure needed to help facilitate smooth trading (hiring tens of thousands of customs officials, getting the port facilities upgraded to cope with the extra customs and regulatory checks required, etc). If this passes it obviously takes “no deal” off the table while the extra time in the transition gives business a little more breathing space to prepare for future arrangements and should therefore prove to be supportive for economic activity. It would also increase the chances of a Bank of England interest rate hike this year and provide a boost for sterling.

However, if Theresa May fails to renegotiate the backstop and it looks as though the UK is about to crash out of the EU without a deal then Part 2 would kick in. It would see the UK asking for a transitional period even though there is “no deal”. Again extended to 2021 – thereby removing the threat of an abrupt hard Brexit if the EU agrees. In return, the UK would continue paying into the EU budget at around £10bn per year (roughly half a percent of annual GDP) with EU citizens’ rights guaranteed. This would provide the time that the Conservatives believe is need to either prepare for a WTO trade relationship or a new trade deal.

A long way to go...

Again, there are clearly problems with this. The EU will be reluctant to agree to a transitional deal without a formal Brexit agreement, especially as it still leaves open the possibility of a hard Irish border after 2021. Nonetheless, as Brexit day gets closer and tensions mount it could be the framework that at least provides some insurance and if realised will be a major relief to business and UK assets, at least in the near term.

More fundamentally we are sceptical that 2021 is a long enough transitional period (and the 2020 transitional period currently proposed on paper is almost certainly not). After all, it has taken the UK and EU two and a half years since the Brexit referendum to get to just this stage. To put it in context the Canada EU-trade deal took seven years to negotiate and required all national governments to approve it. The UK-EU trade deal will be far more complex – being both deeper and broader given the high levels of trade already conducted involving complex supply chains and the need to include services, which dominates the UK economy.

With disagreement over the availability of technology that can minimise trade frictions, we suspect that we may see an eventual extension beyond even a 2021 transitional period. There is the very real prospect that it may have to go beyond the 2022 scheduled General Election. As such we expect to spend many, many more hours watching parliamentary Brexit votes before Britain truly breaks its ties with the EU.

Author

James Knightley

Chief International Economist

james.knightley@ing.com

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