Does May's speech put Brexit back on track?

PM May's speech was conciliatory yet thin on details and is likely to receive a lukewarm response from the EU

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Lack of fresh detail unlikely to get talks fully back on track

Brexit discussions had seemingly headed into a cul-de-sac with both London and Brussels expressing frustration and accusing each other of obfuscation. Not enough headway was being made on the financial settlement, EU citizens' rights and the status of the Irish border – three key areas the EU needs to see progress on before approving the start of talks on the future relationship between the UK and EU later this year.

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The fear that talks could remain deadlocked, threatening economic damage and the UK dropping out of the EU without a deal in place has prompted the British Prime Minister to intervene. But in a long and meandering speech in Florence, we learned little except “no deal is better than a bad deal”.

Talk about transition period is key

The most significant point is that we get a formal proposal for an “implementation period” with the UK willing to make ongoing contributions to the EU in return for ongoing access to the single market. This is envisaged to last “around two years” and will involve ongoing free-movement of labour, but there will be a registration system for new arrivals. She didn’t mention the hotly contested “final settlement” – which would involve an additional payment to cover costs including pension liabilities, legal commitments and contingent liabilities.

She didn’t mention the hotly contested final settlement

As for the longer term, May insisted on a bespoke arrangement that is “imaginative and creative”. The UK will not be adopting an “off the shelf” package, such as the EEA as with Norway or the CETA trade deal with Canada and will leave both the single market and the customs union. This will allow it to strike deals with other countries.

We will have to wait and see how Europe responds to this. Talks between the negotiating teams are scheduled to start again on Monday with the vote on whether talks can progress onto trade, scheduled for 19/20 October European Council summit.

Cliff edge risks delayed, but not removed

Given the economic and financial linkages, the supply chains and the millions of jobs that are so dependent on frictionless trade for both the UK and the EU we are hopeful economic sense will prevail, and an outline for a transitional arrangement will be agreed in coming months. If this is achieved, it will give clarity to businesses right across Europe.

In terms of the UK specifically, while it certainly won’t resolve all of the Brexit uncertainty – a post-transition deal remains a long way off. The fact that there will be no major changes in the UK-EU trading relationship for the next three and a half years may encourage companies to invest more in the British economy. That said, the threat of a cliff edge has not completely disappeared – it could still happen in 2021.

Bottom Line

If there is a little more business optimism and this translates into stronger economic activity, this could see the Bank of England becoming more inclined to raise interest rates. Inflation is currently 2.9%, and employment is at record levels. An improved growth outlook makes it more likely the BoE will remove its emergency stimulus, helping to cement market expectations for two hikes by the end of 2018. That said, we don’t think this will mark the start of a meaningful tightening cycle. But this could add more momentum to sterling’s recent strong run.

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