

UK-EU tensions cast a cloud over recovery in cross-channel trade

UK-EU trade flows have recovered from January's collapse, albeit it's less clear by how much. However, simmering political tensions stemming from the Northern Ireland protocol risk injecting further uncertainty if a deal on food standards isn't agreed upon, and we instead head towards retaliatory tariffs



Source: Shutterstock

UK-EU tensions simmer as Northern Ireland protocol row continues

Five months into the UK's new economic relationship with the EU, and Brexit is back in the headlines as [tensions rise](#) ahead of the G7 meeting in Cornwall, UK.

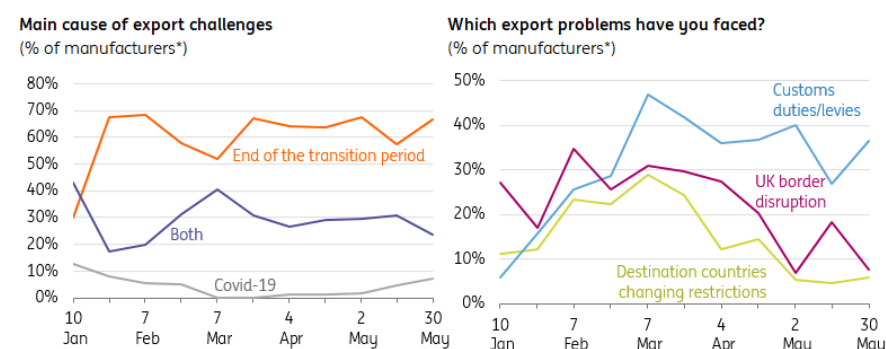
The latest disagreements aren't new. Both sides are attempting to reach a political agreement on the implementation of the Northern Ireland protocol – the part of the withdrawal agreement that's designed to avoid a return of a hard border on the island of Ireland. That agreement – originally struck back in October 2019 – essentially keeps Northern Ireland (NI) aligned with the EU's single market rules for goods and requires customs processes for shipments 'at risk' of moving from NI

into the Republic of Ireland.

In practice, this makes trading between Great Britain and NI a complicated process, particularly for supermarkets and other food wholesalers, given much of the burden falls on agricultural products. Over recent months, the [UK has accused Brussels of a lack of flexibility](#) in implementing the agreement. The [EU argues](#) that the UK is not following what it signed up to.

Brexit and customs paperwork the biggest challenge for manufacturers

(Data from ONS bi-weekly Business Impact survey, and both are displayed as a percentage of manufacturers that normally export and have faced challenges/disruption)



Source: ONS Business Impact Survey

In particular, the EU was left frustrated by a UK decision to unilaterally enable businesses to avoid filling export health declarations when shipping goods to NI from GB until October, an extension of a grace period due to expire at the start of April. The UK is threatening to do something similar to a second grace period, covering food safety checks, which expires at the end of June. The UK government argues the deadline risks halting chilled meat shipments to the region.

This latter issue – which has been colourfully described in the UK press as a [‘sausage war’](#) – sounds pretty narrow and fairly specific, but it is symptomatic of the erosion of trust between both sides. Many had hoped relations might have improved after the often-fractious negotiations last autumn.

UK-EU relations could go one of two ways

Despite both sides noting the urgency of the situation, there’s no guarantee a quick fix will be found. But ultimately, the issue could go one of two ways.

A more optimistic scenario would see Britain agree to align on food standards. David Frost, who leads Brexit-related issues for the UK government, has not ruled out some alignment, though has for now [pushed against expectations](#) of a full sanitary and phytosanitary (SPS) deal. The latter option would get rid of most of the bureaucracy relating to food shipments, not only for goods headed to Northern Ireland but also between the UK and EU more widely.

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fractious negotiations last autumn

Economically this kind of approach would reduce a thick layer of uncertainty and burden for businesses. However, it would, in theory, limit the UK government's hand in trade negotiations with other countries. For example, part of the British reluctance to align more closely with EU food standards is a desire to strike a trade deal with the US. But the US under President Joe Biden appears a) more focussed on stability in NI, and also b) doesn't seem to be in a rush to push ahead with trade talks as the focus is centred on domestic policy. Interestingly, ahead of the G7, [the US has signalled](#) that if the UK aligned with EU agricultural rules, it wouldn't necessarily scupper chances of a US-UK deal.

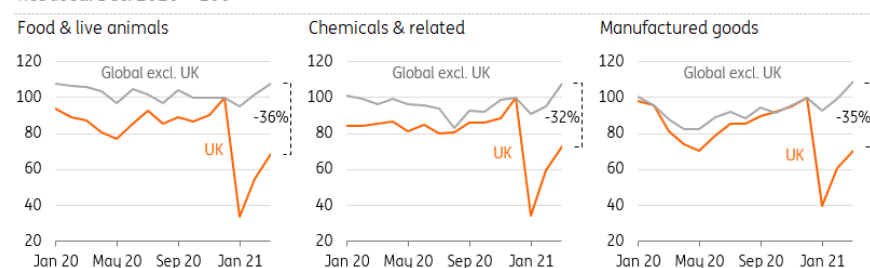
The UK farming community's negative reaction to negotiations with Australia is also a reminder that retaining the flexibility to move away from the EU's stricter food standards is not universally popular domestically.

The alternative – negative – outcome is that the EU pushes ahead with legal routes that could ultimately lead to retaliation. Brussels has already kick-started two parallel sets of legal action, both of which in time could trigger tariffs on UK goods to the EU if a remedy isn't found. This process is only likely to gain momentum if the UK unilaterally decides to extend the next grace period.

The UK's share of overall EU imports has fallen, according to Eurostat data

Imports to the EU27

Rebased: Dec. 2020 = 100



Source: Macrobond, ING calculations

Trade flows have recovered but still lag the rebound in world trade

As the political debate rages on, we'll get another month's worth of data this week on how trade between the UK and Europe is faring – though so far, the evidence is mixed.

One thing that is clear is that the situation has improved markedly since January. Back then, couriers had stopped shipping between the UK and the continent owing to reams of incorrect paperwork, while Covid-19 border closures in December were still taking their toll. Since then, the proportion of firms reporting being unable to export from the UK at all, or facing 'severe disruption', has gradually fallen, according to a bi-weekly ONS survey.

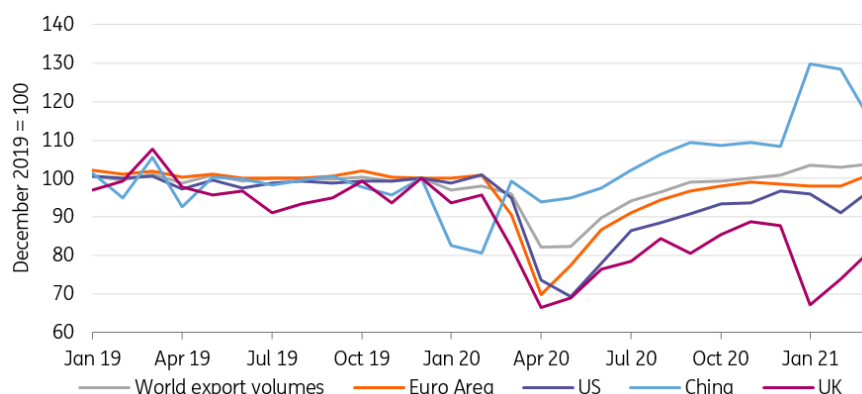
The situation has improved markedly since January

But as to how far the trade has recovered since January, the picture is less clear. As of March and based on UK-produced stats, we know that British exports to the EU had regained most of the lost ground since December. April data from France also suggests a further improvement. Admittedly, imports have been slower to recover, but then again, these were less affected by changes in January given the UK has deferred the implementation of checks on its side, and also firms heavily stockpiled in Q4 last year.

Take a look at the data from Eurostat (the EU's stats agency), however, and the picture on UK exports to the EU is less rosy. By this measure, trade is still down by over 20% on December, but more importantly, it signals that UK shipments are lagging when world trade is recovering. The chart above shows that's true in a range of major categories. The chart below, courtesy of our International Trade team, shows the UK similarly lagging in trade volumes tracked by the CPB monitor.

With UK and EU-produced figures so far providing a wildly different picture of the recovery, we're going to have to wait a few more months for a clearer picture (though for [a few reasons](#), the Eurostat figures may currently be the more useful out of the two).

Trade volumes are lagging behind Europe and the US



Source: CPB World Trade Monitor
Chart created by Joanna Konings

Trade frictions a medium-term drag on UK economy

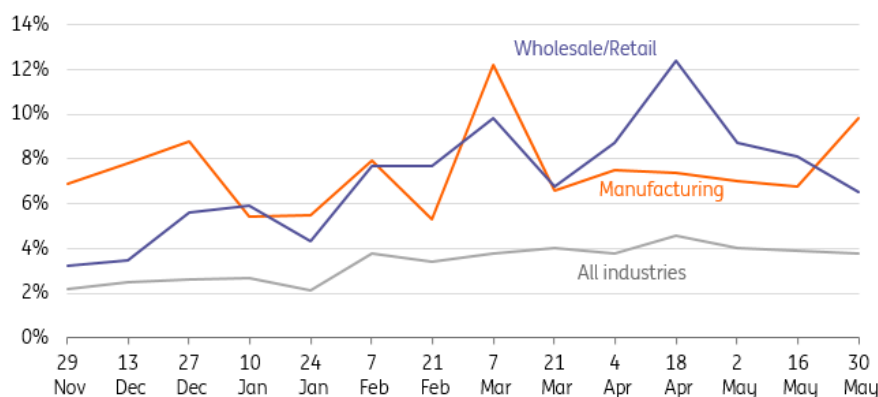
Still, when we put this all together, it's clear that UK trade with Europe still has some catching up to do despite the improvement. And it's a reminder that the overall impact of Brexit on the UK economy is likely to be a slow-burner from now onwards. That's partly because we won't know for some time how much damage has been done on the services side, and in fact, many of the changes won't become apparent until travel starts up again. For goods, we may also encounter another bumpy patch in various sectors when the UK government introduces full customs requirements for inbound shipments from late-2021/early 2022.

Survey evidence suggests we've only seen a steady stream of firms adjusting their supply chains

so far (chart below), though we'd expect this to be a gradual process. One common mitigation seems to be setting up extra warehousing to insulate against higher costs (for example, because of rules of origin requirements) and customer delays.

In big-picture terms, none of this is likely to noticeably affect the wider economic growth path for the next year or so - that depends much more heavily on Covid-19. But in the medium-term, as the pandemic's impact fades, the effect of trade frictions will inevitably persist.

Has your business made supply chain changes in preparation for/due to the end of the transition period? (% firms in sector)



Source: ONS Business Impact Survey

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