Quilter

Brexit: Where are we now?

June 2020

With less than a month to go until the UK has to formally decide whether or not to extend the Brexit transition period past 31 December 2020, we take a look at where Brexit currently stands and the impact the coronavirus crisis has had on negotiations.

The start of 2020 saw renewed optimism in UK markets following the decisive victory by Boris Johnson's Conservative Party in the general election in December, and the passing of the Withdrawal Bill through Parliament to enable the UK to officially exit the European Union (EU) on 31 January.

However, what many saw as the end of the Brexit process was really just signalling the beginning of intense trade negotiations to agree a trade deal by the end of the agreed transition period in December 2020.

Boris Johnson and the UK government were unsurprisingly bullish about being able to agree terms with the EU without the need to extend the transition period, with many expecting the 30 June deadline to ask for an extension to pass without it being activated.

Changing priorities

But within weeks of the UK 'taking back control' through Brexit, the coronavirus pandemic has seen the priorities of governments in the UK and across the EU understandably switch to combating the effects of the disease. While Brexit has been knocked off the front pages, negotiations have been continuing behind the scenes, albeit with limited success.

What progress has been made?

The UK attempted to set out its trade position in mid-May with the publication of the UK Global Tariff (UKGT) system, which would come into effect from 1 January 2021. The new regime looks to streamline and simplify almost 6,000 tariffs, including scrapping all 'unnecessary' tariffs and those below 2%, and removing tariffs on £30bn of imports that enter UK supply chains. However, it maintains tariffs on agricultural, automotive and fishing products.

The government claimed that the UKGT would ensure "60% of trade will come into the UK tariff free on World Trade Organisation (WTO) terms or through existing preferential access from January 2021".

At the same time the UK published the draft legal text used as a basis for its negotiations, accompanied by a rather blunt letter from the UK's chief negotiator David Frost that suggested a somewhat frosty relationship between the UK and the EU.

Mr Frost's letter on 19 May claimed the EU was insisting on "additional, unbalanced, and unprecedented provisions in a range of areas" before an agreement could be reached, rather than seeking to rapidly settle a deal with a close economic partner. He added: "Overall, at this moment in (the) negotiations, what is on offer is not a fair free trade relationship between close economic partners, but a relatively low-quality trade agreement coming with unprecedented EU oversight of our laws and institutions."

In return the EU's chief negotiator suggested the next round of talks scheduled for June would require a new dynamism to create "tangible and parallel progress" across all areas of negotiation if the two sides were to avoid a stalemate. Ultimately, it will take political will on both sides to unlock the current impasse, rather than negotiation over video conference, with larger issues such as fishing rights, the degree of government regulation and issues around financial services also needing input from elected decision makers.

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>
> **David Frost, chief negotiator for the UK**

Where next?

The UK has already pulled people from Brexit duty to help with the coronavirus, so there is the potential that the UK asks for an extension to help get the economy back on track.

Paul Craig, portfolio manager at Quilter Investors, says: "Given the fragile state of the UK economy, and provided the government does not mishandle the Brexit negotiations, we believe the setup is ripe for targeted fiscal stimulus to help homebuilders and carmakers, providing a supportive backdrop for UK mid-cap companies, helping to get the country back to normal."

But he adds: "What investors should be more concerned about is the exit from this fiscal and monetary expansion. Markets have shown it was a struggle to remove the policies of the 2008 financial crisis, so it is important that we have a plan for how to get back to a 'normal' environment."

Deal or no deal

However, some have suggested that the damage from the coronavirus pandemic might provide 'economic cover' for a 'no deal' Brexit and the resulting financial hit. Phil Hogan, the EU's trade commissioner, suggested that the coronavirus pandemic could provide the perfect excuse for a 'hard' Brexit in December with no deal, adding that it appeared the UK doesn't want to "drag the negotiations out into 2021 because they can effectively blame [the coronavirus] for everything".

Richard Carter, head of fixed interest at Quilter Cheviot, says: "The UK government seems firm on not wanting to extend the transition period given that Boris Johnson campaigned at the December election on the premise of "getting Brexit done". So it feels as though we have a few months of fraught negotiations ahead, which is likely to climax in some sort of classic European late-night summit with either an agreement or not at the end of it."

Mr Carter notes: "The biggest impact and volatility is likely to be felt in the currency markets, where no-deal is likely to be deemed 'bad' for the UK and therefore it will push sterling lower. In that scenario, having plenty of exposure to international shares and indeed UK companies that derive the majority of their profits abroad will help investors as these assets are likely to perform well in this environment. Broadly speaking, we would expect more UK domestic and smaller companies to suffer in the way they did post-referendum, albeit the impact is likely to be complicated by the ongoing pandemic situation, which has also had a big impact on smaller, domestic stocks in the UK market."

Unsurprisingly, most businesses appear currently preoccupied with the coronavirus, with many potentially feeling like they have done all they feasibly can in terms of preparation and planning for Brexit no matter the outcome.

Mr Craig adds: "There are some good companies in the UK, and businesses have had three years to plan and prepare for Brexit. In addition, the coronavirus has certainly focused corporate minds on costs and strong balance sheets more recently. This means there could be plenty of opportunities available, and given that UK equities, especially small and mid-cap companies, are far from the top of investors' wish lists, the rewards could be high if an acceptable agreement with the EU is actually reached."

If an extension is agreed before the end of June, then markets will likely take this as encouraging, with evidence of goodwill on both sides. The risk is that politics, and the need for both sides to be seen to take a tough negotiating stance get in the way, setting the way for tense negotiations at the end of 2020, when time really will be running out.

The political view

Peter Duncan, a former Conservative MP and managing director at political consultancy Message Matters, says:

"The challenge of delivering a deal by the end of this year has been made exponentially more difficult by the impact of the coronavirus. That said, whilst the times may be unprecedented – the challenges remain fundamentally unchanged. Will the EU accept a non-tariff arrangement with a country so fundamentally intertwined with its economy? Will the UK prove willing to concede on issues like fishing to deliver major gains in, for example, financial services.

"With a looming deadline at the end of June, when agreement that a deal is possible has to be reached, a deal remains there to be done in the time available if the will is there to make it happen. Both sides could do with setting aside growing acrimony to deliver some good news as they fight to restore their economies after the pandemic."

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