Swedbank

Brexit briefing

A guide to the UK's exit from the EU

Negotiations have entered a critical phase, while disagreements persist

With only 44 days left of 2020 and the transition period, negotiations between the EU and the United Kingdom on their future trade relationship have entered a critical phase. Talks were intensified on October 22 and have resumed in Brussels this week, following some progress during last week's sessions according to the British chief negotiator David Frost. The two parties' drafts for the treaty texts are said to be similar, and earlier reports from the European Commission suggest that the EU and UK share views on how to trade in goods and services after the United Kingdom's transition period ends on December 31.

There are still, however, considerable disagreements on the main sticking points, where progress has been lacking. Fishing rights remain a major issue, not for economic purposes from a British viewpoint as fishing makes up less than 0.1% of UK GDP, but mainly because the UK wants sovereignty. It is also a trump card for the UK in negotiations, since the EU wants to retain extensive access to British fishing waters. The topic of a level playing field, notably regarding state aid, is also contested as the EU insists on common rules and standards to prevent British businesses from attaining competitive advantages to EU firms. The parties are also divided on governance, i.e., how to enforce trade commitments and respond to breaches.

An agreement remains our baseline scenario, but the risk of a no-deal lingers

Although differences remain on the key sticking points, the EU and UK have made progress on the economically important areas of trade in goods and services, and both parties will on aggregate benefit from a deal. Given this, our belief is that a deal is still the more likely outcome. Domestic pressure on both sides, but most notably on the British, to reach an agreement has recently increased. Typically deals tend to be struck near the last minute, which we believe is on the cards also this time.

The deal will, however, probably be rather thin, and fall short of the high ambitions during the start of negotiations. A partial deal should also not be ruled out, in which the EU and UK agrees on some key areas such as goods and services trade, while leaving other parts to be negotiated after the transition period ends. Such an outcome could potentially relieve some domestic pressure, while delaying politically sensitive concessions. From a market perspective, this would still likely be interpreted positively as the focus mainly has been on trade, although talks have included other important topics such as equivalence for financial services.

While the short time frame may force the parties to compromise, it also implies that there may not be enough time to reach an agreement at all. This risk is especially large for a wider, mixed agreement that will require a more comprehensive EU ratification (read more below). Any type of deal will have to be ratified in record time, and in less than half the time it took for the EU to ratify the Withdrawal Agreement.

Time for reaching a deal is running out, as ratification of an agreement is required

In the UK, the Constitutional Reform and Governance Act (2010) allows for ratification by the government 21 sitting days after a treaty has been laid before Parliament. The process can be shortened if necessary. The government is, however, not required to schedule a vote, but the House of Commons or Lords can delay the process by passing a motion against ratification, although this scenario is unlikely.

EU ratification is more intricate and ultimately depends on how extensive the potential agreement will be, and the areas covered in the deal. In any case, an agreement will need the approval of both the European Parliament and Council. This is also sufficient for ratifying an "EU-only" deal, i.e., an agreement that only covers areas in which the EU has the exclusive right to legislate. However, if the agreement is "mixed", meaning that member states also can legislate in certain areas of the agreement, then consent from member states' legislatures is also required. But approval of a mixed deal can still be speeded up if necessary, either by member states deciding to limit ratification to the European Parliament and Council, or by provisionally applying the deal until member states have voted, which can take place after the transition period ends.

Brexit timetable

Date	Event
Mid- to late November	Likely the deadline for reaching an agreement to allow for ratification before the end of the transition period
November 19	EU Summit (video conference)
November 23-26	European Parliament holds a plenary session
December 10-11	EU Summit (Brussels)
December 14-17	European Parliament holds final plenary session of 2020
December 31	End of the transition period, the UK exits the customs union and single market

Source: European Parliament, European Council & Swedbank Research

A trade deal is the best outcome for markets and the Swedish economy

A deal between the EU and the United Kingdom is anticipated to positively affect financial markets, with Sterling expected to appreciate moderately. Conversely, the event of a no-deal will likely spur negative investor sentiment and rising EURGBP and USDGBP, which has previously followed backlashes in the process. The movements will likely be larger in the no-deal event than under the deal-event, as markets appear to partially price for an agreement. Either way, the market reaction will mostly be confined to British and some European assets, given that global sentiment is primarily driven by virus and vaccine developments for the time being.

From a Swedish perspective, a no-deal will likely have a gradual effect on trade, as the UK has decided on a stepwise implementation of tariffs and declaration requirements during 2021. As important is the fact that the British exit is certain, meaning that companies have had a few years preparing for the British exit. The risk is, however, that small and mid-sized companies are worse prepared than large companies and that focus in 2020 has been on the corona crisis rather than on Brexit preparations. Finally, the EU will implement full border controls immediately after 2020 ends, which likely will cause delays in deliveries of British goods to the EU.

An agreement between the EU and the United Kingdom will, however, probably contain few, if any, tariffs or quotas. But the British withdrawal from the customs union and single market will, even if an agreement is reached, still imply increased costs for Swedish firms trading with the UK due to customs formalities, legal costs from regulatory differences, rules of origin and adjusted supply chains, and export- and import declarations. Overall, we expect the economic impact on Sweden from any outcome to be limited and gradual, and excluding the effects stemming from the trade sectors the long-run implications will be small. The effects may also hit companies unevenly, where some businesses are unaffected while others face larger challenges. One of the most evident long-run risks will be regulatory breaches and changes to product standards, which cause uncertainties to business planning ahead.

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