

FINANCIAL MARKETS

WHAT DOES A **SOFT** **BREXIT** MEAN FOR GBP?



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WILL IT BE A SOFT BREXIT AFTER ALL?

FOREWORD

Brexit predictions are a tricky business. But it now seems likely that the UK will end up with a “Soft Brexit”.

Of course, nothing is certain. But the latest political developments in Westminster suggest that a “No Deal” Brexit is now off the table.

The purpose of this eBook is to define what a “Soft Brexit” could look like - and how it might influence GBP.

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WHAT IS A SOFT BREXIT?

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The markets have always favoured a “Soft Brexit” when compared to a “Hard Brexit”.

In fact, it’s fair to say that investors and businesses have been anxious about the prospect of a so-called “No Deal”. In this scenario, the UK would leave the European Union (EU) abruptly. This is what “Hard Brexit” describes.

Remember - the lack of a transition is likely to disrupt UK businesses that trade with the EU. Certain industries could face new trade barriers, as the UK would move to World Trade Organisation (WTO) rules in a “Hard Brexit”.

However, a “Soft Brexit” would see the UK maintain close economic alignment with the EU.

There are various “Soft Brexit” options. At the time of writing, UK

parliament seems to be leaning towards some form of customs union with the EU.

Let's explore this option in more detail.

CUSTOMS UNION OPTIONS

First, let's clarify what the EU customs union actually is.

It's essentially a trade deal between all 28 EU member states. It allows goods to move freely between those member states without customs duties or quotas.

The customs union also allows all 28 member states to negotiate trade deals as a bloc.

The customs union is different from the single market. The single market is an agreement between the 28 member states to freely accept the movement of goods, capital, services and goods.

From recent indicative votes in parliament, it appears that there could be a majority for the UK to remain in some form of customs union with the EU after Brexit.

However, entering a customs union was something the UK government was originally unwilling to do, as it would prevent the UK from being able to negotiate its own trade deals.

This is a critical point. Part of the appeal of Brexit (according to leading Brexiteers) is the ability for the UK to negotiate its own trade agreements.

Common Market 2.0

An alternative customs union arrangement, which the Labour party backed in the last round of parliament's indicative votes, is known as "Common Market 2.0".

Arguably, its the softest form of Brexit. It would involve the UK becoming a member of the European Free Trade Association (EFTA) - like Norway and Iceland.

Specifically, it would see the UK remain a part of the single market and accept the free movement of people. In addition, it would see the UK make smaller EU budget contributions without as much influence on its rules.

Proponents of this idea also suggest that the UK could align with the EU customs union, without officially being a part of it. They say this could resolve the Irish border issue.

However, many Brexiteers believe that this arrangement does not satisfy the Brexit mandate of 2016.

Similarly, many Remainers are dissatisfied with this approach, as it essentially keeps the UK tied to the European Union while giving up its influence. There's also the matter of securing an agreement from the EU, which is likely to be difficult.

WHAT IS LIKELY TO HAPPEN NEXT?

It's difficult to determine what will happen next with Brexit. At the time of writing, Prime Minister Theresa May is in talks with Labour

to find a form of Brexit that will command a majority in parliament.

She has been forced to take this approach, as her Withdrawal Agreement has been rejected three times by MPs (including many Conservative MPs).

However, if press reports are to be believed, talks between the two major UK parties are not progressing well. Labour is looking for the Prime Minister to abandon her “red lines” - something that she reportedly is unwilling to do.

If talks ultimately result in an impasse, the UK government has indicated that it will initiate a process in parliament to determine where a majority lies.

Regardless, the UK has asked the EU for another extension to Article 50 until Sunday 30th June.

In a letter to Donald Tusk, President of the European Council, Prime Minister Theresa May explained that another short extension was necessary to try and find consensus between the UK government and opposition about the “future relationship” before the Withdrawal Agreement could face the House of Commons again.

Prime Minister Theresa May hopes this can be achieved before Wednesday 22nd May to avoid the UK taking part in European elections.

At the time of writing, the UK is still set to leave the EU on Friday 12th April, without a deal. However, it’s expected that the EU

will agree to some form of conditional extension at a summit on Wednesday 10th April.

INFLUENCE ON GBP

Any form of “Soft Brexit” will relieve the anxieties of investors and businesses.

Remember - one of the major arguments against Brexit is its potential for economic disruption. It’s why the pound sterling dropped by more than 10% after the EU Referendum result in 2016. Its value has been pegged to the progress of Brexit negotiations ever since.

With this in mind, a “Soft Brexit” that involves a customs union will likely act to strengthen the pound sterling (GBP), as investors and businesses will not have to adapt to new customs rules.

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