FINANCIAL MARKETS

WHAT IS A SOFT BREXIT?

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ONLY 10 MONTHS TO GO

FOREWORD

With just 10 months to go until Brexit, what it will actually look like is far from certain.

Some are pushing for a so-called 'soft Brexit'. This includes prominent UK political figures, who are supposedly keen to protect Britain's economy.

The purpose of this eBook is to analyse what soft Brexit would actually mean - and how it could affect the financial markets.

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CEO, Blackwell Global Investments (UK) Limited

HARD BREXIT VS. SOFT BREXIT

WHAT IS A HARD BREXIT?

For those who are unaware, a hard Brexit means that Britain will sever its deep economic ties with the EU and leave the single market.

This will change all of its current trading rules. It also means that Britain will take full control of its immigration system.

If a hard Brexit is to go ahead, Britain would be free to trade with any nation under the rules of the World Trade Organisation. It would also be free to negotiate free trade deals with other countries and economic blocs - including the European Union.

Economists for Free Trade claim that leaving Europe could effectively add £135 billion a year to the British economy if it secures favourable free trade deals. This would be due to lower-priced imported goods and the effect of increased competition as firms raise their productivity.

However, securing favourable trade deals is a complex and lengthy process - such an outcome is far from guaranteed.

THE FINANCIAL IMPACT OF HARD BREXIT

It has been estimated that leaving the EU could cost UK businesses around £65.5 billion per year.

As well as losing trade, the UK could still owe the EU £20 billion in the form of unpaid bills.

Though it is not impossible to successfully create a deal, some analysts believe that the UK would be less well off in the short-term. The current EU consumer market has about 500 million people with a GDP of approximately €12 trillion.

Just less than half of the UK's current exports go to EU countries. This trade makes up around 12.5% of the UK's GDP - which is somewhat significant.

On the other hand, 56% of UK exports do go to non-European regions. Without tariff and non-tariff barriers, there is the opportunity to create trade agreements that cover any lost EU trade.

It is important to remember that the UK is the second-largest economy within the EU. It contributes €14.1 billion to the region's GDP. In return, it only gets €7.1 billion back in subsidies. So, many question if the UK is getting enough out of its contributions.

When looking at the economy, we also have to understand that a good deal for the UK is not necessarily a good deal for the rest of Europe. A hard Brexit could, in fact, have damaging effects on other European nations.

Take the Netherlands for example. A hard Brexit or no-deal could make every Dutch person €1,000 poorer. Dutch companies would have to secure licences for 4.2 million exporting and 750,000 importing companies. These licences can cost €80-€130 each.

WHAT IS A SOFT BREXIT?

A soft Brexit would be any deal negotiated with the EU that is anything less than a complete withdrawal.

There are several outcomes that would indicate soft Brexit. The most likely would be a "strategic partnership agreement". This would mean that the UK could resume its control on immigration, but the EU and the UK would retain mutual market access.

The problem that many will find with this option is the likeliness of the UK still having to fully comply with EU legislation. This would be for all goods and services that are imported or exported within the single market.

If this route were to be taken, 27 EU governments would have to allow the UK to stay in the EU during another transition period. Eventually, the UK would come to an observer status within the organisation. Here, it would possibly comply with altered legislation.

As well as having to stick to EU legislation, the UK might be expected to continue paying its financial contributions. This would generally depend on the outcome of the negotiation. Remember, the financial cost of being an EU member caused many to vote for Brexit in the first place.

Trade agreements are also not certain under a soft Brexit - and again could be subject to negotiations. The UK may keep its privileged status in the EU trading system, or it could establish a new relationship with the EU single market under the World Trade Organisation framework.

THE FINANCIAL IMPACT OF SOFT BREXIT

The financial impact of a soft Brexit isn't clear - but it's probably the arrangement the markets and big business would favour.

Remember, following the Brexit vote, GBP fell to a six-year-low against EUR and a 31-year low against USD. This was the market's way of saying it didn't favour Brexit.

However, fast-forward to 2018 and GBP has regained this lost ground. The UK economy is also showing signs of resilience - including record levels of unemployment.

Securing a soft Brexit is likely to result in more of what we see at the moment, whereas a hard Brexit would likely cause more volatility.

Keep in mind that easier and closer trade will always be favoured by the financial markets.

UNITING POLITICAL FOES

AN UNLIKELY TRIO

Brexit has had the unusual effect of uniting former political adversaries.

After five years away from British politics, David Miliband (a former Labour Foreign Secretary) has grouped up with Nick Clegg (a former Liberal Democrat Deputy Prime Minister) and Nicky Morgan (a former Conservative cabinet minister) to persuade fellow MPs to support a soft Brexit.

The trio believes that Britain is being ‘held to ransom’ by the more hardline Brexiteers. They also say that a hard Brexit is not the best option on offer.

ECONOMIC WORRIES

All three politicians worry about the economic impact that hard Brexit could have.

They explained that there would be a growth drop by 5% over the next 15 years, even with a comprehensive free trade agreement with the EU.

What's more, they say that the UK could find itself with limited access to the largest markets in the world - meaning the idea of a 'global Britain' is far from accurate.

As proposed bills are discussed between MPs - Miliband, Clegg and Morgan want MPs to use their voting power to prevent long-term damage to the country.

By highlighting a supposed threat to jobs and living standards, these political heavyweights demonstrate how Brexit is not a 'right' or 'left' political movement.

Critics say that Miliband, Clegg and Morgan represent the political class who don't understand the Brexit vote. Many 'Vote Leave' campaigners favour a complete break from the European Union, including from the single market and customs union.

The EU has recently warned Britain that they were running out of time to seal finalise a Brexit deal. We are likely to see key developments outlining the British position over the summer of 2018.


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