



R&R Weekly Column
By Brunello Rosa



UK: The Return Of Brexit Tensions And The “No-Deal” Risk

Last week the UK government presented [a bill to regulate the smooth functioning of the internal market](#) following the withdrawal of the UK from the EU on January 31st, 2020, which will exert its full effects starting from January 1st, 2021, at the end of the so-called transition period. As has been [widely reported by the media](#), many clauses of the internal market bill override the provision of the so-called Northern Ireland (NI) protocol, which was signed between the EU and the UK alongside the Withdrawal Agreement (WA) in order to ensure that a physical border between Northern Ireland and the Republic of Ireland does not return following the UK’s departure from the EU.

As was clear from the very beginning, the implementation of the so-called Irish backstop would have effectively put a customs and regulatory border in the Irish sea, de-facto breaking the “union” of the Kingdom, while leaving Northern Ireland within the EU customs union. For that reason, [Theresa May repeatedly refused to accept that option](#), considering that “no UK prime minister could ever accept” such a condition. Boris Johnson instead revitalised the plan, and that was the key to unblocking the negotiations with the EU in November 2019, perhaps knowing that he would have reneged that pact less than a year later.

The UK government has [explicitly said in parliament that the internal market bill would break international law](#) and that the government’s intention was in fact that of overriding the Withdrawal Agreement with domestic legislation. Top EU officials (starting with the leaders of the Council and the Commission, Charles Michel and Ursula von der Leyen, respectively) have called on the UK to respect the pacts signed with the Withdrawal Agreement and the NI protocol (*pacta sunt servanda*, tweeted von der Leyen).

Where does all this leave the ongoing UK-EU negotiations? The two sides agreed that any deal would need to be reached by the EU Council by October 15th, to give enough time for EU parliament and national parliaments to ratify the treaties. For this reason, [the EU sent the UK the ultimatum of either withdrawing the internal market bill](#) or making it compatible with the Withdrawal Agreement and NI protocols by the end of September 2020, in order to have at least 15 days to make a final attempt to strike a skinny free-trade agreement (FTA): this FTA would be even less ambitious than the one the EU recently signed with Canada (the so-called *Canada-minus* FTA). But it is self-evident that, given the tight schedule, the risk of a no-deal scenario has returned with a vengeance.

Is this just hard-ball negotiation tactics by Boris Johnson? One could suspect that, with deadlines approaching, the two sides are trying to play chicken to see who gives up first. That’s a possibility. However, Boris Johnson is on the record saying that for him a no-deal scenario is a perfectly legitimate and desirable outcome. Also, “no deal” is the only logically consistent end-point of his entire Brexit campaign. Finally, no deal is the only way the UK would have a proper and final clean break from the rest of the EU, allowing maximum freedom in terms of state aid, taxation and regulatory divergence. It would be the final and cherished prize to secure in return for all the hardship of Brexit. Therefore, we do not think that this is just negotiation tactics. If the final outcome is no-deal, Johnson would sell it as his personal victory.

What’s wrong with a “no-deal” outcome? While the UK can gain something in the short term from reneging on the pact with the EU that was signed just a few months back, doing so would represent a terrible precedent. For a country aiming at “striking trade deals around the world” ([such as the one it recently signed with Japan](#)) as the “Leave” propaganda said, being perceived as a counterparty that not only does not respect its word, but does not even respect the treaties it signs, would be a terrible signal to send to other countries that could be potentially interested in striking a deal with the UK. The UK has taken hundreds of years to move from encouraging piracy to providing one of the most reliable legal systems in the world. If Boris Johnson decides to go down that route, it could cause severe damage to the country’s international reputation. With the UK already being [one of the countries hardest-hit](#) by the economic repercussions of Covid, its PM needs to be careful in inflicting more damage from the effects of a no-deal Brexit, even if ([as we discussed in our column of May 11th](#)) he could get away with it in the short run by blaming Covid for the economic consequences of a disorderly exit from the EU.

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Looking Ahead

The Week Ahead: US Consumption Likely to Remain Subdued And Central Banks To Remain On Hold

In the US, in August retail sales are expected to remain subdued at 1.1% m-o-m (p : 1.2%). The Fed is expected to remain on hold at its September 2020 FOMC meeting, the first meeting after its Chair Powell announced the CB would tolerate higher inflation.

In the EZ, core CPI inflation is projected to rise to 1.2% y-o-y (p : 0.4%).

In Japan, the BoJ is also seen to keep its policy rates unchanged at -0.1%.

In England, the BoE is expected to leave the key interest rate unchanged at 0.1%.

The Quarter Ahead: US-China Tensions Remain Elevated, Brexit Uncertainties Linger; Central Banks Remain Cautious

In the US, the government has revoked the visas of more than 1,000 Chinese students and researchers—who are deemed to be a security risk. The move follows a statement by President Trump in May aimed at Chinese nationals suspected of “*having ties to the military, stolen data, and intellectual property*”.

In China, Beijing is expected to impose “*reciprocal restrictions*” on all American diplomats in response to earlier curbs on the activities of its embassy staff in the US. The unspecified countermeasures will apply to all US embassy and consulate staff, as well as the consulate-general in Hong Kong. Also, China will keep opposing a forced sale of TikTok’s US operations by its Chinese owner ByteDance, and would prefer to see the video app shut down in the US, rather than be sold to potential US buyers—such as Microsoft and Oracle.

In the EZ, ECB’s President Lagarde statement that “*the ECB would carefully monitor the exchange rate*” was perceived as dovish by the markets and led to EUR appreciation. President Lagarde also reiterated that “*the bank is ready to do more, if needed*”.

In the UK, PM Johnson has accused the EU of “*imposing a full-scale trade border down the Irish Sea and a food blockade*” between Northern Ireland and the rest of country. Meanwhile, the UK struck its first big post-Brexit trade deal, as it reached a historic agreement with Japan—expected to increase trade by GBP 15bn per year. The deal entailed a compromise on agriculture, under which the UK will have access to “*export quotas for cheese and other products that have not been used by the EU*”. The agreement with Japan comes at a crucial moment for Johnson, as his move to unpick parts of the Brexit withdrawal treaty risks the collapse of trade talks with Brussels.

Last Week’s Review

Real Economy: Global Risks Hamper The Recovery, Inflation To Rise, Central Banks Maintain Easing Bias

In the US, the number of ‘unemployment benefits claims’ remained unchanged at 884K in the week ending on September 5; while the number remains high, ‘claims’ were below 1m for two weeks in a row—for the first time since March. In August CPI inflation increased to 1.3% y-o-y (c : 1.2%; p : 1.0%) and core-CPI rose to 1.7% y-o-y (c : 1.6%; p : 1.6%)—the highest rates since March.

In the EZ, in Q2 the economy shrank by -11.8% y-o-y (p : -3.7%)—the biggest contraction on record, but lower than initially estimated (c : -12.1%); as coronavirus-related restrictions hurt most sectors, the EZ is officially in recession.

In Japan, in Q2 the economy shrank an annualized -28.1% (c : -28.6%; p : 27.8%)—the biggest slump on record, reflecting the severe impacts of COVID-19.

Both the ECB and the BoC kept their main policy rates unchanged – at 0.0%, and 0.25%, respectively. Both CBs reiterated their willingness to support the economic recovery, as necessary.

Financial Markets: US Stocks Decline, Led By Technology; Bonds Stable. Oil Down, Gold Up

Market drivers: investor sentiment was hampered by concerns about: *i*) the fundamentals-valuation disconnect; *ii*) slowing progress in the US labor market; and *iii*) delays in COVID-19 vaccine development, as AstraZenica paused its trials. Global stocks declined w-o-w (MSCI ACWI, -1.2%, to 566) driven by the US (S&P 500, -2.5% to 3,341)—where equities fell for the second straight week, as technology stocks experienced their worst pullback since March. In Europe, stocks rose (Eurostoxx 50, +1.7% to 3,316) lifted by positive economic data, in spite of *i*) disappointment that the ECB did not announce additional stimulus; and *ii*) renewed fears of a hard Brexit.

Fixed income: w-o-w, bonds rose mildly (BAML Global, +0.2% to 297.8); the yield on US Treasury notes declined modestly (10y UST, -6bps to 0.67), pulled down by the news of the pause in the AstraZeneca trials.

FX: w-o-w, the USD gained against most currencies (DXY, +0.7% to 92.719; EUR/USD, +0.1% to 1.185).

Commodities: oil prices fell below 40 USD/b for the first time since July (Brent, -6.6% to 39.8 USD/b), as Saudi Arabia cut oil prices for some customers. Gold rose (+0.5% to 1,942 USD/Oz.), supported by market interest for safe heavens—as longer-term CB interest rates ticked higher.



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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year

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