



Holger Schmieding, Chief Economist | Holger.schmieding@berenberg.com | +44 20 3207 7889

NOT GOOD ENOUGH: UK BREXIT PLAN RAISES FIVE EU CONCERNS

Berenberg Macro Flash

Some progress – but the UK still has to change its position significantly further to get a revised Brexit deal: this sums up the initial EU reaction to the [new Irish border plan](#) which UK Prime Minister Boris Johnson has submitted to Brussels. The EU will negotiate with the UK for as long as possible. It wants a deal, largely because it needs the UK as a reliable friend in geopolitical matters (such as dealing with Putin and Trump) rather than as an aggrieved loner harbouring a grudge against its big neighbour EU. However, the EU is not prepared to ditch its own red lines. Any revised deal on the Irish border needs to be acceptable to Dublin as well as the EU parliament.

Substance versus the blame game

The EU reaction needs to be seen from two different angles. First, in terms of the blame game. Second, in terms of actual substance.

The EU is still not sure what game Johnson is playing. Johnson's rhetoric at the Tory party convention ("our final offer" etc.) supports the suspicion that he is merely trying to shift the blame for a likely failure of Brexit talks onto the EU in his bid to impress his hardline base ahead of potential early elections. However, the tone and contents of the actual letter suggest that he may want detailed negotiations on substance. In this regard, the letter differs from the more abrasive posture which the UK had taken in talks with EU leaders and negotiators since Johnson came to power.

Some progress – but five problems remain

In terms of substance, the EU sees clear progress on one key point: Johnson's new proposal would avoid a regulatory border on the Irish isle by keeping Northern Ireland in the EU single market for all goods, not just for food and agriculture.

However, the UK proposal raises five serious concerns:

- 1) It requires **customs and VAT checks** between Northern Ireland and the Republic of Ireland after the end of the transition period.
- 2) The UK wants to give the Northern Irish parliament (the currently defunct "Stormont") the **right to unilaterally cancel** the participation of Northern Ireland in the EU single market for goods after four years. If so, that would then require regulatory checks and not just customs checks between Northern Ireland and the Republic of Ireland. The EU has so far rejected the idea that a backstop could be cancelled unilaterally or be limited in time.
- 3) Under Johnson, the UK now wants to deviate more from EU standards than it had signed up to in the draft agreement negotiated under then-Prime Minister Theresa May. The UK now intends to **drop the commitment to a level playing field**. Such a greater regulatory



MACRO NEWS

divergence would require tougher border controls between the EU and the UK. In turn, this would make the Irish border issue even more relevant and more difficult to resolve.

- 4) **Lack of time.** With just two weeks left until the EU summit of 17-18 October and just four weeks until the supposed Brexit day of 31 October, the EU doubts that the issues can be resolved and that a revised deal can be ratified or made legally binding in any other way beforehand. After all, the EU has a parliament as well. Procedures of the multi-nation club EU take time.
- 5) Most fundamentally, the new UK proposals fail to address the EU's key point. In the UK, the **"Irish backstop"** is often treated as a potential blueprint for the future long-term economic relationship between the EU and the UK. This underpins the fear in some UK circles that the UK could be "trapped" in the EU customs union indefinitely. The EU sees the backstop merely as a last-resort guarantee to keep the Irish border open if all other attempts to do so fail. UK proposals for decentralised and low-intrusion customs checks away from the border and other "technological solutions" are welcome. The EU is happy to test them during the transition phase and – if they work – settle for them in the end. But to precommit to such untested solutions now without a "backstop" guarantee would require a leap of faith by Dublin and the EU. With his rhetoric and behaviour, Johnson has not encouraged the EU to trust him enough for that. For ideas how the backstop could be modified from an EU angle, see ["is a backstop compromise still possible?"](#).

We expect a flurry of negotiations in coming days. Acutely aware of the blame game risks, the EU will continue to talk and explain its position, sticking to its line of "progress, but the UK needs to shift its position further". Whether or not the UK will do so remains the key question. Given the expectations which Johnson has raised among Brexit hardliners and his very precarious position in the UK parliament, that does not seem likely. As it stands, we probably have to brace ourselves for another Brexit extension to be followed by either new elections in the UK in late 2019 (more likely) or a new referendum in spring 2020 (possible but less likely). For a second referendum, the UK opposition would have to get its act together, topple Johnson and install an [interim prime minister to serve until after such a "deal or remain" referendum](#)

This message has been produced for information purposes for institutional investors or market professionals, it is not a financial analysis within the meaning of § 34b or § 31 of the German Securities Trading Act (Wertpapierhandelsgesetz), no investment advice or recommendation to buy financial instruments. The message does not claim completeness regarding the information on the developments referred to in it. On no account should it be regarded as a substitute for the recipient's procuring information for himself or exercising his own judgements. The message may include certain descriptions, statements, estimates, and conclusions underlining potential development based on assumptions, which may turn out to be incorrect. Berenberg and/or its employees accept no liability whatsoever for any direct or consequential loss or damages of any kind arising out of the use of this message or any part of its content. -- For full economics reports please visit our website or contact capitalmarkets@berenberg.de.

Joh. Berenberg, Gossler & Co.
KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7889
www.berenberg.com
holger.schmieding@berenberg.com