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## UK-EU TALKS: RISING RISK OF A DISORDERLY EXIT

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#### ***Stuck at an impasse***

In the absence of an unlikely political intervention, we do not see much hope of major progress in the fourth round of UK-EU trade talks that are ongoing this week. The two sides remain [too far apart on key issues](#) such as level playing field rules, governance, the Northern Irish border and fishing rights. The risk of a breakdown in negotiations ahead of 30 June – the latest possible day for the UK to ask for an extension of the transition period that expires on 31 December 2020 – looms large. On top of the huge economic damage from [the badly handled pandemic](#), a disorderly exit from the single market presents an additional risk factor to the UK.

UK Prime Minister Boris Johnson is reportedly seeking high-level talks with EU President Ursula von der Leyen ahead of the 30 June deadline. It often takes a high-level intervention to push such talks forward. Remember Johnson's walk in the park with Irish Prime Minister Leo Varadkar in October 2019? It yielded the breakthrough that allowed the UK and EU to settle on the final text of the Withdrawal Agreement. Four reasons suggest we should be less hopeful about such a breakthrough this time around, however:

- 1) The UK seems to be renegeing on its commitments regarding the special status of Northern Ireland that are set out in the Withdrawal Agreement; the UK insists that goods travelling from Great Britain into Northern Ireland will not require physical checks at the border if the UK leaves the single market without a trade deal.
- 2) The UK government is adamant that it will not request or accept a request to extend the transitional period and may walk away from the talks altogether if it sees no hope of settling a trade agreement by the end of the year.
- 3) Having won a safe parliamentary majority last December, Johnson is under much less pressure to avoid a hard no-deal exit from the EU's single market and customs union than he was last autumn.
- 4) In late 2019, the Irish border was the key issue. Once Johnson made a key concession acceptable to Varadkar, the entire EU happily accepted that. Von der Leyen has neither any obvious reason nor the power to change the mandate that the 27 EU member countries have given the Commission. She is highly unlikely to make Johnson any offer that deviates from the EU's current position.

#### ***Uncertain outlook***

Securing a deal on future EU-UK relations by the end of the year seems overly optimistic, in our view. More likely, the UK and EU will neither strike a deal nor extend the transitional period. Instead, they may merely agree to some modest stopgap measures to prevent a fully disorderly exit at the end of the year. Instead of one big cliff edge, where the UK-EU economic relationship suddenly shifts from single market rules to World Trade Organisation rules, the UK and EU could agree to make the switch in a series of smaller steps to make it easier for businesses and citizens to adjust. Talks in late 2020 may focus on how to best manage such a hard exit.

An orderly outcome partly hinges on the UK adhering to the commitments it has made on the Northern Irish border. Before the EU agrees to anything, the UK will need to ensure that there will be no new frictions on Northern Ireland's southern border with the Republic of Ireland. The customs protocols and infrastructure on the Great Britain-Northern Ireland border need to be ready in time for the UK's exit from the single market. Given the lack of progress so far, and increased tensions between the two sides, we must watch the tail risk of a disorderly exit more closely than before.



## MACRO NEWS

### ***Hard exit – will anyone notice?***

Some UK commentators argue that, in the wake of the pandemic chaos and with the ongoing massive fiscal and monetary stimulus, a disorderly outcome would probably be less noticeable than in better times. While this is partly true, the impact will still be highly visible. A collapse in talks followed by a hard unmanaged exit would hurt confidence, spending and investment. Queues at the ports and the Eurotunnel would be highly visible. The UK would likely suffer a comparatively slower recovery from the pandemic recession than other major European economies. In a worst-case scenario, a disorderly exit could tip the UK back into recession in early 2021.

An ideal outcome would be for the UK and EU to agree that the UK will remain in the single market for goods for an extended period to provide more time to negotiate an ambitious free-trade agreement while ensuring an orderly exit from the single market for other areas of trade like services and finance. Both sides could probably sell that as a win.

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