THE 500KM DISPUTE

Aneeka Gupta – Director, Macroeconomic Research
11 Feb 2019

Parliament’s vote on 29 January delivered one clear message – Parliament opposes a “no deal” Brexit but it was not ready to delay Brexit. This underscored the combined success of the Brady and the Spelman amendment among the 7 others that were tabled by the speaker John Bercow. The Brady amendment seeks to remove the most controversial part of the Brexit deal with the European Union (EU) – the Irish Backstop. The border that runs for 500km separating the Republic of Ireland and Northern Ireland has been one of the biggest sticking points during the Brexit negotiations. The Spelman amendment clarifies that a majority exists within the House of Commons that favour avoiding a disorderly Brexit. The other two important amendments that were defeated – Cooper (sought an extension of Article 50) and Grieve (sought to gain more time for alternative Brexit options).

The Irish backstop

The new negotiating objectives under the Brady amendment conflict with the red lines laid down by Theresa May. The UK’s current red lines include – (1) leaving the EU’s customs union (2) maintaining an open border between Ireland and Northern Ireland and (3) keeping frictionless trade with the UK’s continental partners. An agreement on the backstop is key because it is a safety net that will apply to the Irish border after Britain leaves the EU. This backstop is designed around British red lines, ensures maintaining cross-border cooperation, supporting the all-island economy and protecting the Good Friday peace agreement. Under May’s current deal Northern Ireland would stay aligned to some rules of the EU single market, if another solution cannot be found by the end of the transition period in December 2020. This would mean goods coming into Northern Ireland would be subject to additional checks to maintain compliance with EU standards. This has remained the main contention of MPs owing to concerns the UK would continue to follow EU rules for an indefinite time without having any mechanism to withdraw unilaterally from it. The backstop has also been opposed by the DUP, a Northern Ireland unionist party, that declined to accept any additional Northern Ireland only checks as it could threaten the integrity of the union. Unless the British red lines were to change in terms of their approach to the Customs Union and the Single market, we are unlikely to see the EU changing their approach to the backstop.

Figure 1: The UK-Ireland border

Source: Bloomberg

What's next?

Theresa May now faces the uphill task of returning to the EU with a 2-week deadline to re-work the best offer that makes the backstop more palatable. It's unlikely that the EU will play ball and the prospect of gridlock looms large. It looks like we are back where we started. Since the European Commission President Jean-Claude Juncker, deputy chief negotiator Sabine Weyand, and French President Emmanuel Macron have all said the so-called backstop is not up for renegotiation. In a statement issued after the votes, the Irish government said its position on the Brexit deal has not changed and it would continue its preparations for a no-deal scenario. In the interim, the government is also running 'the Alternative Arrangements Working Group' (AAWG) which serves the dual purpose of focusing on the backstop and involving Labour MPs through social/ worker right concessions. The group combines both the Leave and Remain MPs to seek an alternative to the backstop on the Irish border. The next meaningful vote should come by February 13, following May's revised deal with the EU and this is when the Parliamentary majority in opposition to "no-deal" will exert pressure. So far, no major Brexit outcome can be ruled out entirely. While Theresa May has managed to retain control of the agenda in the interim by bringing the hard-Brexiteers on her side, we might find ourselves seeking an extension to Article 50 on February 13, if the EU refuses to budge.

Seizing the opportunity as Brexit uncertainty peaks

The ongoing Brexit saga has impacted both the UK and European economies over the last 2 years. In the case of UK, its economy has suffered tangible losses such as a slowdown in GDP growth and a contraction in house prices. Most business and consumer confidence gauges in the UK have fallen below their long-run averages. Nonetheless, UK confidence data is weak but not worse than its Eurozone counterparts. Euro area growth has also declined to its slowest pace in 4 years. This was largely due to external headwinds such as global trade tensions and a slowdown in Emerging Markets (EM) known to be a key source of demand for European exports. Since the start of 2019, we have seen a turnaround in EMs and trade frictions starting to abate allowing Eurozone equities to stage a modest recovery.

Sluggish growth will likely hinder attempts to normalize monetary policy further. The

European political landscape will witness a marked change in 2019 – with German Chancellor Angela Merkel stepping down after 20 years at the helm, parliamentary elections in May, European Central Bank President Mario Draghi's 8-year tenure ends and UK's departure from Europe. We believe Europe is deeply under-owned, risks have largely been priced, valuations are compelling, offering some room for further upside. For investors looking to gain a tactical exposure to Europe, investors may turn to a strategy that tilts its exposure to the higher yielding segments of the market such as financials, energy, communication and utilities. UK stocks have corrected sharply over the last year and are trading at valuations last seen during the great financial crisis 2007-2008. While Brexit uncertainty peaks and sentiment remains weak across European equities, we believe taking a high yielding income approach to gain exposure to European equities could be a prudent option to consider. While it is hard to predict the exact outcome in politics, we expect common sense to prevail at the eleventh hour as both economies make every effort to avoid a disorderly Brexit scenario.

Related blogs

+ Bre-main

View the online version of this article here.

<u>Important Information</u>

Marketing communications issued in the European Economic Area ("EEA"): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

The application of regulations and tax laws can often lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.