



Mind Games

Brexit has moved right back up the government's agenda recently as fears grow that the EU-UK trade talks will end in failure this autumn. Ireland is stepping up preparations for a hard Brexit, where the UK would move to trading under WTO rules from the start of next year. Next month's budget will be based on this assumption.

WTO rules would involve the imposition of tariffs on some goods and be very disruptive for both exports and imports. Various studies suggest that a hard Brexit could lower the level of GDP in both Ireland and the UK by some 5-6% within a short number of years, compared to if Great Britain remained within the EU Single Market and Customs Union.

The trade talks have been bogged down for some time around the issue of state aid or subsidies for industries. The EU is insisting that any deal needs to include rules on state aid that are legally enforceable to help ensure a level playing field on trade. The UK, though, wants to have a free hand on setting state aid, with full autonomy over providing state subsidies for industry.

In a bizarre twist, though, the bilateral trade agreement reached earlier this month between the UK and Japan has rules on limiting state aid. Not only that, the *Financial Times* has reported that the template used for these state aid rules is that contained in the EU-Japan trade deal agreed last year. In other words, the UK is replicating the state aid rules in the EU-Japan trade agreement, in its trade deal with Japan.

However, so far it has not been prepared to contemplate similar rules being included in an EU-UK trade deal. In another twist, the UK government has also introduced an Internal Market Bill in parliament, allowing it to renege on elements of the Withdrawal Agreement signed off with the EU last year, thereby breaking international law. This hardly builds trust with the EU in the current trade negotiations.

The question being asked by virtually everyone is what's going on? Are these just negotiating tactics? Is the UK government interested in securing a trade deal at all? Is it hoping that the EU will just walk away from the talks in frustration? Or else by playing it tough, is it looking to secure more favourable terms in a last minute deal, especially on state aid and fisheries.

Whatever the answer, the sterling market has become much more nervous, with the pound coming under significant downward pressure this month on the growing risk of a no-deal Brexit. The euro climbed from below 89p at the start of the month up to near the 93p level over a week ago. Meanwhile against the dollar, sterling fell from a high of \$1.35 to \$1.28. The UK currency managed to recover a bit of ground last week. However, it remains well down on its levels at the start of the month, with trading in the currency turning much more volatile.

The 93p rate against the euro has become a key support level for sterling. It has held this month, just as it did in autumn last year, when there were real fears that the UK could crash out of the EU without a deal. It can be expected to hold in the next few weeks until we get some clarity on the outcome of the EU-UK trade talks.



However, if there is no trade deal agreed and a "hard" Brexit is indeed on the cards, then the 93p support level will almost certainly crumble. Parity with sterling could well beckon for the euro in these circumstances.

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