



BREXIT NEGOTIATIONS

**WHAT
TRADERS
CAN
EXPECT**



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BREXIT: THE HARD WORK STARTS

FOREWORD

Brexit is undoubtedly a topic that will continue to attract the market's attention in the months ahead. This is especially true now that we've entered the early stages of Brexit negotiations.

The UK now has little under two years to negotiate its exit terms with the European Union. It likely to be a complex process - and one which could have a profound impact on the UK economy and pound.

The purpose of this eBook is simple. We will explore what traders can expect from Brexit negotiations and how this might affect their trading decisions.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

WHAT EXACTLY IS BREXIT?

THE UNANSWERED QUESTION

As a trader, you need to be aware that Brexit is proving to be a very fluid situation. This means that the form Brexit takes is far from certain. In fact, it's something the political classes in the UK seem to be undecided on.

At the time of writing (July 2017), the UK seems split on what kind of Brexit should be pursued. This was a key topic in the recent UK election. In the weeks before polling day, British Prime Minister Theresa May seemed to favour something known as 'Hard Brexit'. A key feature of this approach was the UK leaving the European single market (something both investors and businesses have expressed concern about).

However, the result of the UK general election has changed this. Theresa May unexpectedly lost her parliamentary majority - meaning that she now leads a minority government which is dependent on support from the Democratic Unionist Party (DUP).

A fragile minority government means that Theresa May needs to be open to compromise with other parties. When it comes to Brexit, many MPs in the House of Commons favour retaining single market access - as they believe that will help UK businesses thrive and create jobs. Theresa May is now under pressure to deliver a form of Brexit that has cross-party backing.

Theresa May's weakened position has not gone unnoticed in Brussels. The European Union is keen to make progress with the negotiations, despite the internal debates taking place in the UK.

So we're in muddy waters when it comes to defining what the UK wants from Brexit. Of course this is one of the major criticisms of the 2016 referendum. Some argue that Brexit wasn't clearly defined during the referendum campaign, subsequently leaving the UK in a compromised position for Brexit talks.

However, from an economic perspective, there's one big issue that needs to be addressed in the current negotiations - namely future trade relations. We'll explore this in the following sections.

SINGLE MARKET ACCESS

THE BIG ISSUE

The clear focus for traders in Brexit negotiations involves single market access. The markets clearly favour the UK retaining some sort of access to the single market. Evidence of this can be seen in the aftermath of 2016's referendum result, which saw the pound drop to 31-year lows against the US dollar.

Investors clearly saw the 'Leave' vote as a threat to the UK's single market access - it's why we saw a significant sell-off of the pound. But why does single market access even matter? To answer this question, you need to understand what single market access actually is.

WHAT IS THE SINGLE MARKET?

The European single market allows members of the European Union to trade tariff-free with each other. It also sets a common regulatory framework that all members must follow. The advantage

of this approach is that each member has access to a common market of over 500 million people. Given the close proximity of European Union members, the single market can help economies develop prosperous export markets. This has been especially true for the UK, which is a global leader in a number of industries such as financial services and car manufacturing. Having access to the single market has also made the UK an attractive proposition to foreign investors. Remember, foreign direct investment is one of the key drivers of currency price.

One condition of having access to the single market is to accept the European Union's principle of 'freedom of movement'. This is where EU citizens can freely work and live in any member state. This policy was criticised in the referendum campaign, as particular attention was given to the UK's level of immigration and pressures on public services.

THE UK'S CURRENT POSITION

It's unclear if the UK will try to attempt to negotiate access to the single market at this time. The only realistic scenario in which the UK could get access to the single market is if it agreed to the freedom of movement principle (Norway currently has this arrangement). That is unlikely to be acceptable to a large portion of the UK electorate.

If single market access is off the table, negotiations then need to centre on what future trading relationship the UK will have with the European Union.

WHAT LEVERAGE DOES THE UK HAVE?

Those that favour Brexit believe the UK is in a strong position to negotiate a free-trade deal with the European Union. It's important to highlight that the UK is one the biggest importers of EU products. So the argument that European Union needs the UK certainly has merit.

But the issue is slightly more complex than that. The European Union and eurozone are currently enjoying a period of economic growth for the first time in a number of years. The election of Emmanuel Macron as French president has also added some much-needed enthusiasm to the European project. Traders need to be aware that the European Union are keen to send a clear signal that countries can't pick and choose the benefits of membership.

There are also other issues at play in these negotiations. Even at this early stage, we've seen the UK and European Union express differences on the Brexit 'divorce bill' and status of EU citizens living in the UK.

It's possible that the European Union will look to implement tariffs for UK exporters in certain industries. This could give the likes of Germany and France a competitive edge over the UK in attracting foreign direct investment. Whether this happens in reality remains to be seen - but it's something traders should closely monitor.

IMPLICATIONS FOR THE POUND

The problem with negotiating future trading relations is that

it brings prolonged periods of uncertainty. As every trader knows, the markets do not like uncertainty as it erodes investor confidence.

We expect the pound to be volatile as negotiations unfold. This will present some excellent opportunities for intraday traders. Long-term, we think the pound will retain relative strength, as the UK economy has proven to be more resilient than expected following the referendum result. Of course, this is subject to change depending on how Brexit negotiations progress.

We could also see another UK general election if the current minority government proves unstable. Such a scenario could cause weakness in the pound, as this will create more uncertainty about the UK's approach to Brexit.



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