KAMCO INVEST

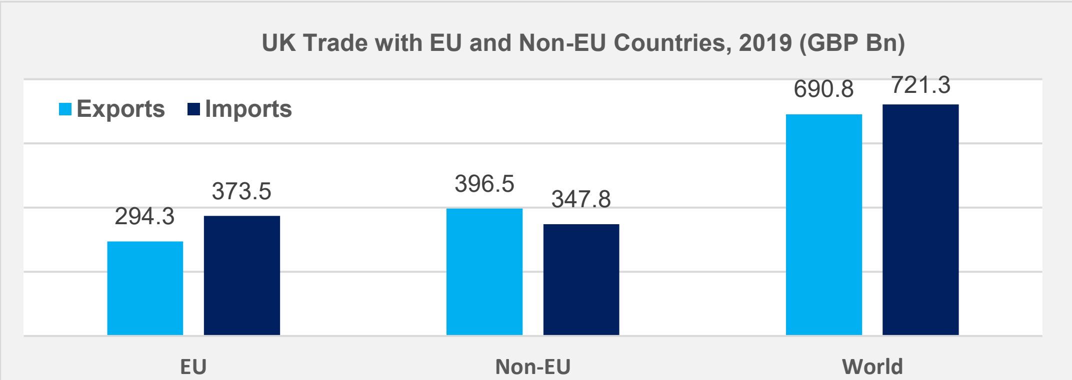
Investment Strategy & Research

Brexit - A Quick Take

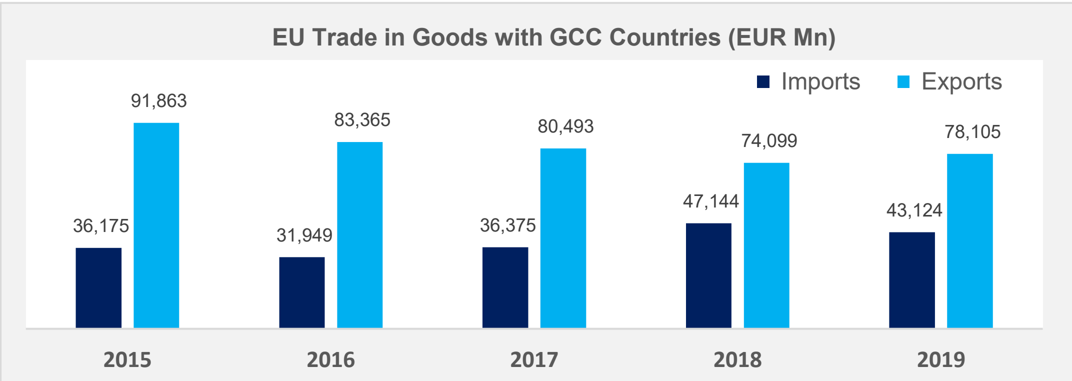
December-2020

Uncertainty fades as Brexit deal is in sight...

- As of today, a Brexit deal is expected to be announced at any minute. Looking back, on the 23rd of June, 2016 the UK voted to leave the EU and on 29 March 2017 the UK government invoked Article 50 in the Treaty on European Union formally starting UK's two-year withdrawal process from the EU. But after two UK general elections and extending the Brexit deadline till 31st December 2020, it looks like that Brexit may finally happen.
- In the coming deal, the UK government has already indicated that freedom of movement of people between the UK and the EU countries will stop. However, since the UK has a land border with the EU (between Ireland and Northern Ireland) it will be interesting to see how that will be dealt with.
- It is expected that in the new relationship, the UK will not be under the jurisdiction of the European Court of Justice.
- Reaching a trade deal is imperative for both the EU and the UK. The EU is the UK's largest trading partner. In 2019, UK exports to the EU reached GBP 294 Bn (43% of all UK exports). Comparatively, UK imports from the EU stood GBP 374 Bn (52% of all UK imports).
- UK trade with the EU is stronger on services but weaker on goods. The UK ran a trade surplus in services of GBP 18 Bn in 2019 outweighed by a deficit in goods of GBP -97 Bn.
- The conundrum between the two sides is that the UK wants access to its biggest exporting market while the EU wants to protect the sanctity of its single market. The EU does not want the UK to have the full benefits of the single market when it left the club without adhering to the same rules and standards. On the other hand, the UK finds it unpalatable to still follow EU rules and standards while it has no say in making those rules.
- To satisfy the concerns of both sides, it is expected that there would be a free trade deal between the EU and the UK. But with costly border checks and regulatory compliance checks, it will increase the cost of trade.



Source : House of Commons Library



Sources : European Union

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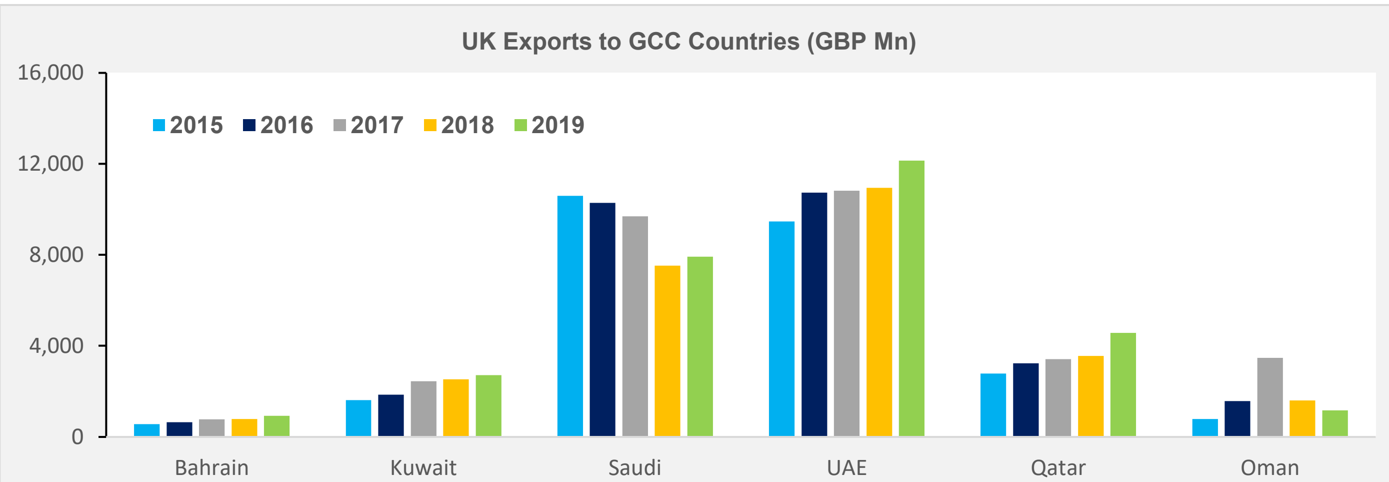
- Since a free trade agreement means unfettered access to each other's markets, there must be a process that ensures that trade between the EU and the UK is fair. Agreeing on the mechanism that ensures that trade between the parties is fair is one of the stumbling blocks of the current negotiation. Another major issue facing the two sides is future change of the regulations and how they will deal with competition, trade disputes and arbitration.
- Another much publicized stumbling block to the negotiations is the issue of fishing rights. Earlier in the negotiations, UK negotiators asked their European counterparts that EU fishing catch by value on British waters should be reduced by 60%, while the EU insisted it can only be reduced by 25%. The negotiations are still ongoing and there are reports that suggest the UK team has compromised and is offering the EU to reduce the fishing catch by 35%. Keep in mind that in 2016, UK fishing and fish processing industries accounted only 0.12% of the UK's total economic output, it is unlikely that fishing alone will derail the talks single handedly.
- If there is no agreement, the UK may crash out of the EU on the 31st December 2020, unless the deadline is extended, which seems unlikely at the moment. Nearly 43% of UK exports go to the EU countries. These goods and services will face immediate disruption in the event of no-deal Brexit. Moreover, new regulatory and customs arrangement would be introduced by both the EU and the UK and this would increase cost of trade. More importantly, a no-deal Brexit would see a hard border erected in Ireland, according to the European Commission.
- Real impact on EU-UK trade can be assessed properly only after Brexit and the terms of Brexit is fully known as EU-UK relationship after Brexit can take many forms.

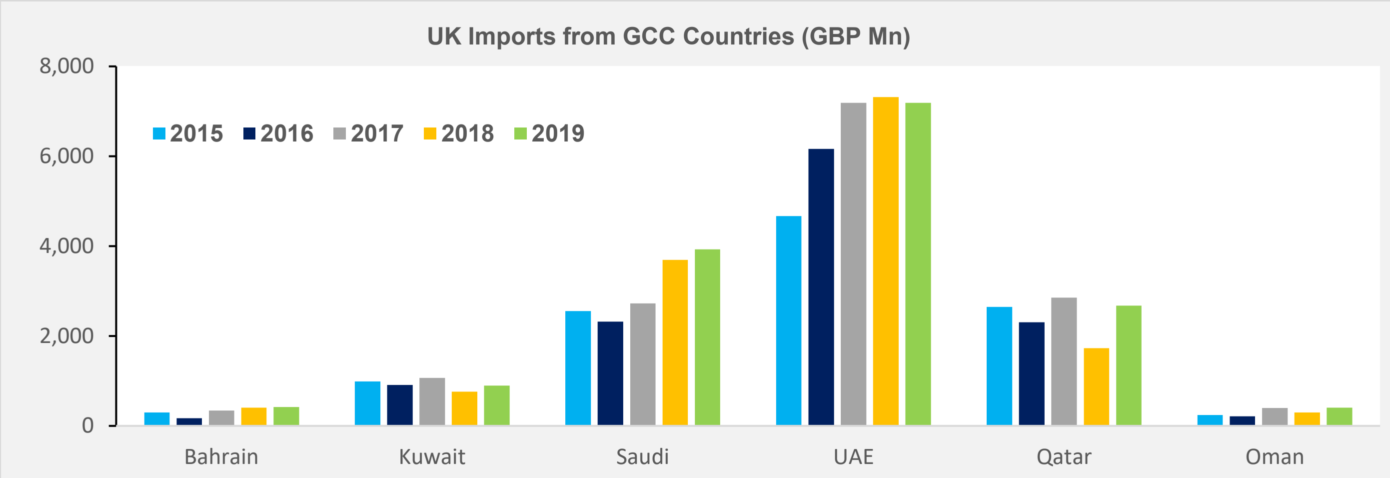
EU and GCC Trade

- The GCC is an important trade partner and export destination for the EU. In 2019, the EU-27 was the fifth largest export destination for GCC goods. The EU imported over EUR 40 Bn worth of goods from the Gulf countries. Similarly, EU goods were the largest imported goods in the GCC in 2019 reaching EUR 89.1 Bn or 21.6% of total goods imported in the GCC countries. Comparatively, the EUR-27 was the second largest trading partner for the GCC in 2019, accounting for 13.7% of its total trade in goods after China (16.8%).
- In 2019, UK goods were the sixth largest imported goods in the GCC or 3.1% of the total goods imported worth EUR 12.7 Bn. The UK was the tenth largest trading partner in terms of goods with the GCC in 2019.
- According to the UK's Office of National Statistics, among the GCC countries, the UAE is both the largest importer and exporter of total goods and services to the UK. Total UK imports from the GCC in goods and services stood GBP 15.5 Bn in 2019 a 36.1% increase from 2015. On the other hand, total UK exports in goods and services to GCC countries reached GBP 29.4 Bn during the same period realizing 14.1% rise since 2015.
- In 2019, 46.4% of all total UK imports in goods and services from the GCC were from the UAE. Similarly, 41.2% of all UK exports to GCC countries in goods and services went to the UAE.
- The British government has been active in boosting its investment in GCC countries. In 2018, the UK Department of International Trade opened a dedicated Dubai office, UK Export Finance Team (UKEF), with GBP 9 Bn fund for UAE projects and another GBP 4.5 Bn fund for Saudi Arabian projects. The UKEF has already financed about GBP 2 Bn worth of GCC projects that secured UK exports between April 2016 and March 2017.



Sources : UK Office of National Statistics

- The UAE, especially Dubai's real estate market, is one of the biggest attractions of UK investment in the GCC. UK nationals are one of the largest investors in Dubai's real estate market. British nationals have invested around GBP 6.6 Bn into Dubai real estate during the four years between 2014 and 2017.
- Some of the ways that Brexit can impact both the GCC and the United Kingdom is it might disrupt the follow of FDI to the UK. UK FDI inflow may experience a period of weak inflow in post Brexit era because companies based in the UK may not be able to access EU market. Britain will therefore need to boost and attract FDI to compensate for such a loss. GCC is one key region that may fill such a gap.



Sources : UK Office of National Statistics

- The turmoil of the COVID-19 pandemic has increased the pressure on both the EU and the UK officials to reach an agreement. Amid the lockdowns, cancellation of travel and economic downturn, no side can afford a hard Brexit which will exacerbate ongoing economic pressure.

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