ARBUTHNOT BANKING GROUP PLC

PERSPECTIVES

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Coronavirus crisis: GDP recovers further in July

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Introduction: GDP continues to recover in July…

GDP rose 6.6% (MOM) in July, following growth of 8.7% in June and 2.4% in May.[1] Despite this, the level of output had not fully recovered from the record falls seen across March and April 2020, and by a considerable margin. July's level was still some 11.7% lower than in February 2020, before the full impact of the coronavirus pandemic and government measures aimed at controlling the pandemic (chart 1a).

Concerning the industrial breakdown:[2-4]

- The services sector grew by 6.1% (MOM) in July, after growth of 7.7% (MOM) in June. Despite July's increase, the level of services output was still 12.6% lower than the level in February 2020 (charts 1a and 1b). The largest contributors to the monthly increase in July were "education" (which grew by 21.1% as some children returned to school); "wholesale, retail and repair of motor vehicles subsector" (which recovered to above its February 2020 level after seeing record low levels of output in April and May); and "accommodation and food service activities" (which grew by 140.8% as lockdown measures eased but the level of output was still 60.1% lower than its February 2020 level). After "accommodation and food services activities", the next most negatively affected sectors were "arts, entertainment and recreation" (still 31.3% below the February level); and "human health and social care" (down 25.7%).
- Production grew by 5.2% (MOM) in July 2020, whilst manufacturing grew by 6.3%. The manufacturing sector saw all 13 subsectors increasing, following large falls across March and April 2020. Despite growth in the latest month, production output was still 7.0% lower than the level in February 2020, with manufacturing 8.7% lower (chart 1a). The other three components of production are reasonably near their February levels.
- Construction recovered by a further 17.6% (MOM) in July, following growth of 23.6% in June and 7.6% in May and a record fall of 40.2% in April 2020. This increase was driven by new housing and, in particular, private new housing which grew by 30.3% after large declines in March and April. Despite July's growth, output remained 11.6% lower than the level in February 2020 (chart 1a).

Chart 1a GDP, major components, breakdown of production, Feb (=100), Apr, Jul 2020

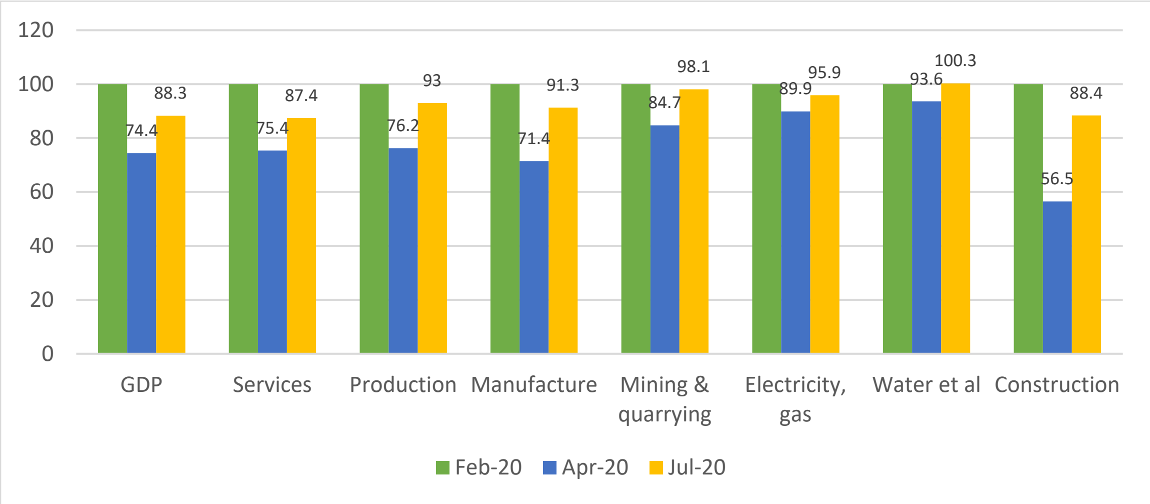
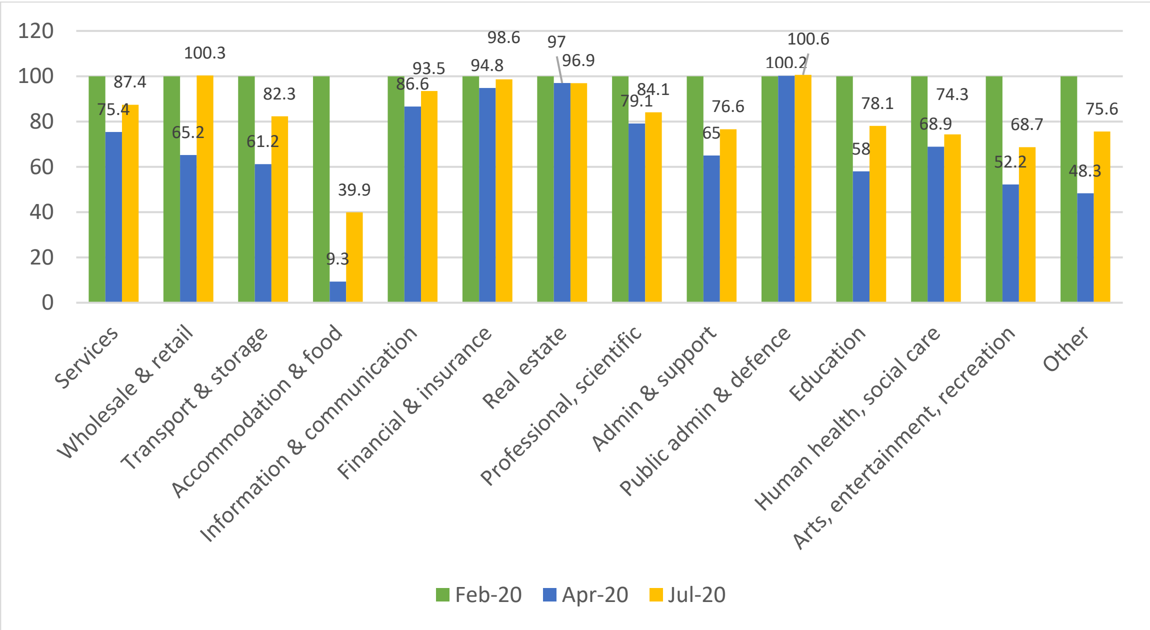


Chart 1b Services, breakdown, Feb (=100), Apr, Jul 2020



Source: *ONS*, "GDP monthly estimate: July 2020", 11 September 2020.

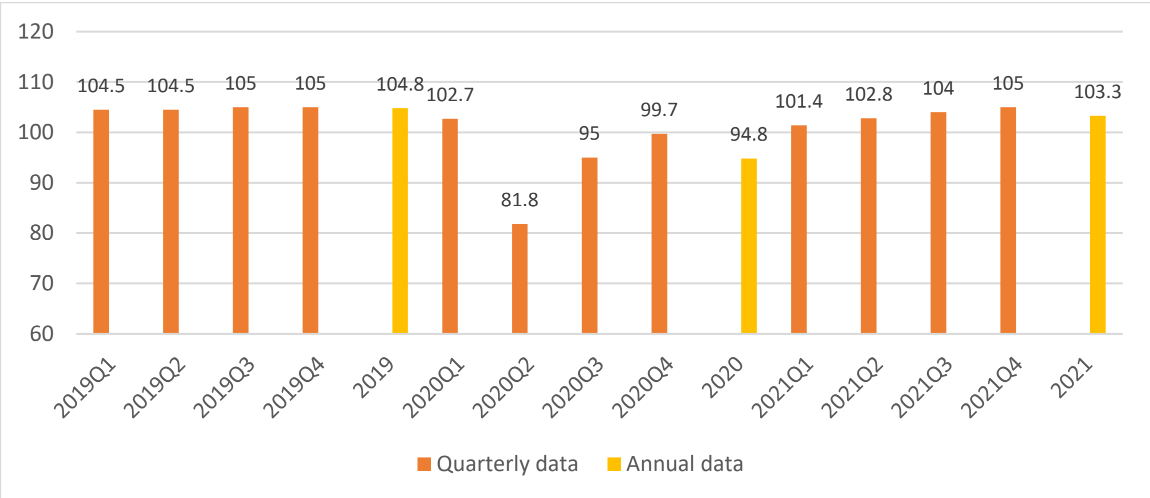
July's improvements partly reflected the further relaxations of restrictions in that month (see annex table 1, mainly England). Places including pubs, restaurants, hotels and hairdressers could reopen (from 4 July) and there were further relaxations including outdoor pools and outdoor theatres (from 11 July). Beauticians, tattooists, spas, tanning salons and other close-contact services could reopen from 13 July, whilst indoor gyms, swimming pools and sports facilities could reopen from 25 July. August's GDP should also benefit from the further relaxations introduced on 15 August (postponed from 1 August), when casinos, bowling alleys, skating rinks and remaining close contact services could reopen, indoor performances could resume and pilots of larger crowds in sports venues and conference centres could take place. Moreover, the Chancellor's Eat Out to Help Out Scheme supported food services activities.[5]

New restrictions to be introduced 14 September (announced on 9 September), limiting meetings with other households to groups of six ("rule of six"), is expected to dampen activity, though at the moment the impact can only be speculative.[6-7] The new rules apply to people meeting in private homes (indoors and outdoors), and places such as pubs, restaurants, cafes and public outdoor spaces, though they do not apply to schools and workplaces (England).

…and a "V" shaped recovery to date

July's data suggest that the recovery to date has been, very broadly, a "V" shaped recovery, as discussed recently when we constructed a Bank-inspired set of projections to 2021Q4 (replicated, chart 2).[8] This illustrative scenario (chart 2) implies that GDP would grow by around 16% (QOQ) in 2020Q3. The first question is whether this is feasible given July's increase. If GDP growth continues in August (at say 2¼%) and September (at say 1¼%), then growth of 16% in 2020Q3 would be achieved. Moreover, such MOM growth rates seem perfectly feasible. The next question is whether the implied 5% (QOQ) increase pencilled in for 2020Q4, given the ending of the furlough scheme at the end of October (for example), is feasible. Granted the world economy's continued recovery should help. But there is the risk that the recovery could falter, especially given the new meeting restrictions (14 September).

Chart 2 Bank of England annual GDP forecast, illustrative quarterly growth path, GDP index, 2016=100



Sources: (i) *Bank of England*, "Monetary Policy Report, August 2020", 6 August 2020, for annual GDP forecasts; (ii) *ONS*, "GDP first quarterly estimate, UK, 2020Q2", 12 August 2020.

External trade is in surplus…

The ONS recently released the trade data for July.[9] In the three months to July total trade (goods and services) showed a surplus of £12.0bn, compared with a small surplus of £0.9bn in the three months to April. The main movement was in the goods balance, where the deficit narrowed significantly to £17.6bn (from £26.3bn in the previous three months), as exports fell by 0.8% whilst imports fell by 9.2% (QOQ). But the services balance also improved. The surplus increased to £29.6bn (from £27.2bn), as exports actually rose 0.3%, whilst imports fell by 5.3%. Suffice to say, the services surplus more than offset the goods deficit.

The ONS pointed out that the goods data were significantly distorted by movements in precious metals (including non-monetary gold (NMG)) and they published an "underlying" series, excluding precious metals. Excluding precious metals, there was still a surplus, albeit a smaller one. It was £6.4bn in the three months to July, compared with a surplus of £0.5bn in the three months to April. Within the total, the goods deficit narrowed to £23.2bn (compared with £26.6bn), as imports fell more than exports. The largest falls in both imports and exports of goods were seen in machinery and transport equipment and fuels, which can be linked to the sharp drop in demand for road vehicles and oil due to coronavirus-related restrictions.

Removing the effect of inflation, the underlying total trade surplus (in volume terms, excluding unspecified goods (including NMG)), increased by £4.1bn to £5.2bn in the three months to July, as imports fell faster than exports. This would contribute positively to GDP.

…and Halifax confirms the bounce in house prices

According to the Halifax, house prices jumped 1.6% (MOM) in August, to be 5.2% higher YOY, the strongest annual rise since late 2016.[10] The average price was a new record high. The Halifax attributed the bounce back to the "…release of the pent-up demand, a strong desire to amongst some buyers to move to bigger properties, and, of course, the temporary cut in stamp duty". However, they warned that "with most economic commentators believing the unemployment will…rise, we do expect greater downward pressure on house prices in the medium-term." Halifax's findings are not out of line with those of Nationwide, which recently reported that, on their series, annual house price growth accelerated to 3.7% in August, from 1.5% in July.[11]

House-moving restrictions were initially introduced by the Government on 23 March (updated on 26 March) in response to the COVID-19 pandemic. The Government advised "house moves should be delayed unless moving is unavoidable". The restrictions were relaxed on 13 May (in England). The threshold for the nil rate band of residential SDLT has been increased from £125,000 to £500,000, operative from 8 July 2020 until 31 March 2021.

Central bank watch: no policy changes from the ECB…

At its latest meeting (10 September) the Governing Council of the ECB kept its policy rates unchanged, commenting that its existing stimulus measures were likely to be used in full.[12-13] Specifically this entailed:

- The interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility were unchanged at 0.00%, 0.25% and -0.50% respectively.
- Purchases under the pandemic emergency purchase programme (PEPP), with a total envelope of €1,350bn, would continue. Net asset purchases under the PEPP would last until at least the

end of June 2021.
- Net purchases under the asset purchase programme (APP) would continue at a monthly pace of €20bn, together with the purchases under the additional €120bn temporary envelope until the end of the year (the latter was announced in March).

…and a modest upgrade to GDP forecasts…

After the major downgrade in June, the ECB modestly upgraded its GDP forecast for 2020 for the Eurozone in September. (The ECB does not provide individual country forecasts.) Concerning their baseline projections, they explained:[14]

- "The coronavirus pandemic has dramatically affected global and euro area economic activity since early 2020. Following a significant drop in 2020Q1, euro area GDP fell by 11.8% (QOQ) in 2020Q2, although this was less than expected in the June 2020 projections. Real-time high frequency indicators started to rebound in May. This suggests a strong yet incomplete rebound of GDP, which is projected to grow by 8.4% (QOQ) in 2020Q3. Thereafter, the baseline rests on the key assumption of a partial success in containing the virus, with some resurgence in infections over the coming quarters necessitating continued containment measures, albeit less so than in the initial wave, until a medical solution becomes available by mid-2021".
- The ECB also constructed a "mild scenario" (which sees the pandemic shock as temporary, with a swift implementation of a medical solution allowing a further loosening of the containment measures) and a "severe scenario" (which sees a strong resurgence of the pandemic, implying a return to stringent containment measures). For the projections for these two scenarios see annex table 2b.

The September macroeconomic baseline projections are shown in charts 3a to 3c and annex table 2a:

- GDP growth was projected to fall 8.0% in 2020 (-8.7% in June), then rebound by 5.0% in 2021 (5.2%) and a further 3.2% in 2022 (3.3%). By the end of the projection horizon, the level of real GDP was expected to stand 3½% below its expected level in the pre-COVID-19 December 2019 projections.
- Concerning consumer price inflation (HICP=harmonised index of consumer prices, chart 3b), the ECB's projections were 0.3% in 2020 (unchanged), 1.0% in 2021 (0.8%) and 1.3% in 2022 (unchanged). The ECB commented "in the short term the previous collapse in oil prices, the appreciation of the euro and a temporary reduction in the VAT rate in Germany imply euro area headline HICP inflation around zero for the coming months". Eurostat recently reported that HICP inflation fell to -0.2% (YOY) in August, reflecting a 7.8% (YOY) fall in energy prices.[15]
- Concerning the labour market (chart 3c), the ECB noted "although unemployment has increased less in recent months than the June 2020 projections had anticipated, the labour market situation is expected to worsen substantially". The unemployment rate is projected to average 8.5% in 2020 (9.5% in June), rising to 9.5% in 2021 (10.1%) before easing to 8.8% in 2022 (9.1%). It was 7.6% in 2019. Eurostat reported that employment fell by nearly 3% in 2020Q2.[16]

Chart 3a ECB baseline forecasts, Eurozone GDP growth (%): March, June, September 2020

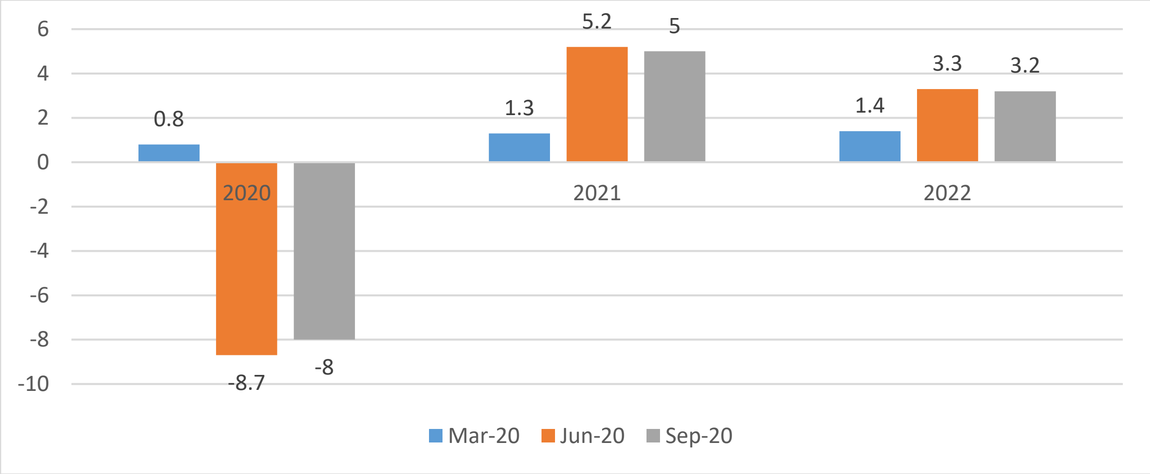


Chart 3b ECB baseline forecasts, Eurozone HICP inflation (%): March, June, September 2020

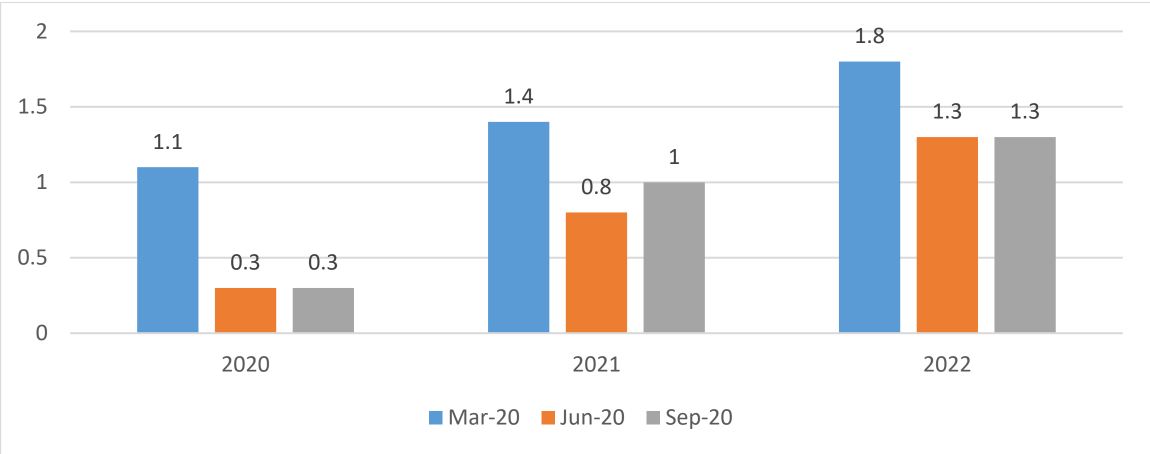
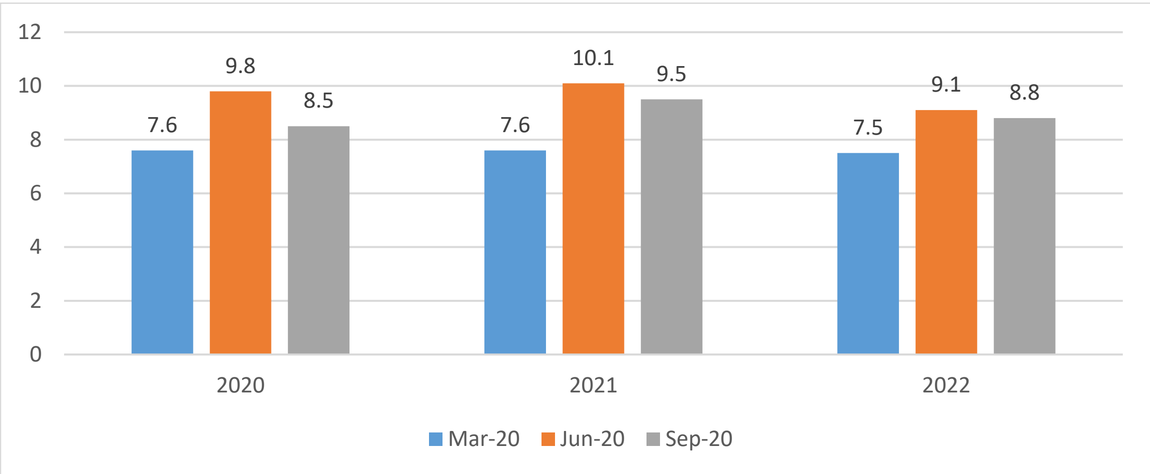


Chart 3c ECB baseline forecasts, Eurozone unemployment rates (%): March, June, September 2020



Sources: *ECB*, "Eurosystem staff macroeconomic projections for the euro area", 10 September 2020 (and previous for March data). See also annex table 2a.

…and the Bank and the Fed meet next week

Both the Bank of England (announcement 17 September) and the Fed (meeting 15-16 September) are due to meet next week. There are few expectations of policy changes.

Concerning the Bank, the MPC minutes should provide further indications of the Bank's thinking on economic developments and monetary policy in the light of the recent cautious statements from the Governor and other Bank officials.[17] The Fed's September meeting follows the recent change in its monetary policy framework, when it switched to an "average" inflation target from a "point" inflation target.[18] The Fed will release its latest economic forecasts which, given the caution expressed at the July meeting, could well be revised down.[19]

Brexit: update

Round 8 of the UK-EU negotiations on the future relationship took place 8-10 September. UK chief negotiator Lord (David) Frost said after the talks:[20]

- "We have just completed our eighth round of negotiations with the EU. We covered all issues in some detail, including the most difficult ones. These were useful exchanges. However, a number of challenging areas remain and the divergences on some are still significant. We have been consistently clear from the start of this process about the basis on which agreement is possible between us. Those fundamentals remain. We have engaged in discussions in all areas. We have consistently made proposals which provide for open and fair competition, on the basis of high standards, in a way which is appropriate to a modern free trade agreement between sovereign and autonomous equals."
- "We remain committed to working hard to reach agreement by the middle of October, as the Prime Minister set out earlier this week." The PM had earlier informed the EU that a free trade deal must be done by 15 October, adding that the UK was entering the "final phase" of negotiations.[21]
- Frost's statement added that he and the EU's chief negotiator, Michel Barnier, were due to continue discussions next week in Brussels, as planned. The next official round (round 9) of talks is due to begin on 28 September.[22]

A related event last week was the announcement of the *Internal Market Bill* by the BIES in Parliament on 9 September, when it was given its First Reading (Commons). MPs will next consider the Bill at Second Reading on 14 September 2020, followed by consideration in Committee of the Whole House on 15-16 and 21-22 September 2020.[23] The *Internal Market Bill* seeks to amend parts of the Northern Ireland Protocol, which was established to ensure there was "no hard border" on the island of Ireland. The Protocol was agreed as part of the revised Withdrawal Agreement (WA), following the re-negotiation of the Withdrawal Agreement and the Political Declaration in October 2019 (see annex tables 3a and 3b).[24] The Government has said that the proposed amendments to NI Protocol are a means of protecting the "integrity" of the UK, concerning trade between England, Scotland, Wales and Northern Ireland.[25]

The official summary of the Bill is:[26]

- "To make provision in connection with the internal market for goods and services in the United Kingdom (including provision about the recognition of professional and other qualifications); to make provision in connection with provisions of the Northern Ireland Protocol relating to trade and state aid; to authorise the provision of financial assistance by Ministers of the Crown in connection with economic development, infrastructure, culture, sport and educational or training activities and exchanges; to make regulation of the provision of distortive or harmful subsidies a reserved or excepted matter; and for connected purposes."

The new Bill sets out rules for the operation of the UK internal market after the end of the Brexit transition period in January. Specifically, it proposes:[27-28]

- Export summary declarations (paperwork): under the Protocol NI businesses must complete export summary declarations when they send goods to GB. It is intended to waive the requirement.
- Tariffs: under the protocol there would be a list of "at risk" goods heading into NI from GB, which could enter the Single Market (via the Republic) and must therefore be subject to tariffs. Goods consumed in NI can have the tariff abated, but businesses warn of the administrative burdens. To lessen the impact the intention is to hand ministers the power to decide which goods are "at risk".
- State aid: under the Protocol the UK must notify the EU of any subsidies that could affect trade between Northern Ireland (NI) and the Single Market. But its potential ambiguity could arguably be exploited by the EU to intervene concerning subsidies for businesses in GB. The intention is to clarify that EU state aid rules would only apply to NI.

References

1. *ONS*, "GDP monthly estimate: July 2020", 11 September 2020.
2. *ONS*, "Index of services, UK: July 2020", 11 September 2020.
3. *ONS*, "Index of manufacturing, UK: July 2020", 11 September 2020.
4. *ONS*, "Construction output, GB: July 2020", 11 September 2020.
5. Ruth Lea, "Further signs of economic recovery, but the Bank strikes a cautious note", *Arbuthnot Banking Group*, 7 September 2020, discussed the Eat Out to Help Out Scheme.
6. *Cabinet Office*, "Coronavirus (COVID-19): What has changed", 9 September 2020.
7. *Daily Telegraph*, "'Rule of six' is too strict, ministers tell PM", 11 September 2020.
8. Ruth Lea, "The coronavirus crisis: retail sales continue to recover whilst public sector net debt exceeds 100% of GDP", *Arbuthnot Banking Group*, 24 August 2020.
9. *ONS*, "UK trade: July 2020", 11 September 2020. The ONS identifies erratic commodities ("erratics"), such as aircraft, ships and precious metals (including non-monetary gold (NMG)).
10. *Halifax*, "House prices rebound to reach record high, challenging affordability", 7 September 2020.
11. Ruth Lea, "Further signs of economic recovery, but the Bank strikes a cautious note", *Arbuthnot Banking Group*, 7 September 2020.
12. *ECB*, "Monetary policy decisions", 10 September 2020.
13. *Reuters*, "European shares fall as ECB leaves policy unchanged with no new stimulus", 10 September 2020.
14. *ECB*, "Eurosystem staff macroeconomic projections for the euro area", 10 September 2020.
15. *Eurostat, "*Euro area annual inflation down to -0.2%: August 2020", 1 September 2020.
16. *Eurostat*, "GDP down by 11.8% and employment down by 2.9% in the euro area: 2020Q2", 8 September 2020.
17. Ruth Lea, "Further signs of economic recovery, but the Bank strikes a cautious note", *Arbuthnot Banking Group*, 7 September 2020.

18. *Daily Telegraph*, "Major Fed policy shift as Powell pledges to overlook rising inflation", 28 August 2020.
19. Ruth Lea, "The coronavirus crisis: sharp GDP falls in US and Eurozone in 2020Q2", *Arbuthnot Banking Group*, 3 August 2020, discussed the Fed's July meeting.
20. *UK Government*, "Lord Frost state after Round 8 of the negotiations", 10 September 2020.
21. *Sky News*, "Brexit: Boris Johnson tells EU that free trade deal must be done by 15 October", 7 September 2020.
22. *BBC,* "Brexit: trade talks hang in balance as UK rejects EU ultimatum", 11 September 2020. The EU warned the UK that it could face legal action if it did not ditch controversial elements of the Internal Market Bill by the end of the month.
23. *Parliament website, "*United Kingdom Internal Market Bill 2019-21", as of 11 September 2020.
24. Ruth Lea, "The IMF downgrades global growth again for 2019, slowest pace since the financial crisis", *Arbuthnot Banking Group*, 21 October 2019, discussed the revised Withdrawal Agreement and Political Declaration.
25. *BBC*, "Brexit: Michael Gove says bill will protect 'integrity' of UK", 12 September 2020.
26. *UK Parliament, "*United Kingdom Internal Market Bill 2019-21", as of 11 September 2020.
27. *Daily Telegraph*, "The Government aims to honour its commitments but avoid confusion", 8 September 2020.
28. *BBC*, "Brexit: PM defends planned changes to Withdrawal Agreement", 9 September 2020, reported that the bill explicitly states that these powers should apply even if they are incompatible with international law.

Annex

Table 1 Coronavirus policy decisions: timeline

Date	Key decisions
2020Q1	
MARCH	LOCKDOWN INTRODUCED, LATE MARCH
3 March 2020, announcement	PM announced 4-phase plan: containment, research, delay, mitigate.
13 March 2020	Government abandoned community testing.
16 March 2020, announcement	PM statement: including encouragement of working from home (WFH); avoidance of pubs, clubs, theatres & other social venues; shielding those with most serious health conditions; social distancing.
23 March 2020, announcement, lockdown	PM statement on lockdown, review promised after three weeks. Slogan: "stay at home, protect the NHS, save lives". New measures: requiring people to stay at home (except for very limited purposes); closing non-essential shops & community spaces; stopping all gatherings of more than two people in public. House moving restrictions introduced (updated 26 March). Social distancing (2 metre guidance).
2020Q2	
APRIL	FULL LOCKDOWN
16 April 2020	First review, lockdown "at least another 3 weeks".

MAY	MINOR RELAXATION OF RESTRICTIONS, MID MAY
10 May 2020, announcement	Announcement: new slogan (“stay alert, control the virus, save lives”). First steps to relaxing restrictions, encouragement to “go to work” (though avoiding public transport), easing of housing market restrictions & outdoor movements. Implemented 13 May (England), see below.
13 May 2020, part relaxation	As announced on 10 May, housing market and outdoor movements.
26 May 2020, announcement	Announcement: outdoor markets & car showrooms can reopen (from 1 June); all “non-essential” retailers can reopen (from 15 June). Implemented.
JUNE	FURTHER RELAXATION OF RESTRICTIONS, EARLY & MID JUNE
1 June 2020, part relaxation	As announced on 26 May, outdoor markets & car showrooms.
8 June 2020	Quarantine rules introduced.
15 June 2020, part relaxation	As announced on 26 May, all “non-essential” retailers.
23 June 2020, announcement	Announcement: places including pubs, restaurants, hotels & hairdressers can reopen (from 4 July); social distancing guidance changed to “one metre plus” (from 4 July). Implemented.
30 June 2020	Local lockdown in Leicester
2020Q3	
JULY	FURTHER RELAXATION OF RESTRICTIONS, EARLY, MID & LATE JULY
4 July 2020, relaxation	As announced on 23 June, pubs, restaurants, hotels & hairdressers.
9 July 2020, announcement	Announcement: further relaxations including outdoor pools & outdoor theatres (from 11 July); beauticians, tattooists, spas, tanning salons & other close-contact services (from 13 July); and indoor gyms, swimming pools & sports facilities (from 25 July). Implemented.
11,13 July, part relaxations	As announced on 9 July. Outdoor pools & outdoor theatres (from 11 July); beauticians, tattooists, spas, tanning salons & other close-contact services (from 13 July)
17 July 2020, announcement	PM announcement of “next chapter” of the Government’s COVID-19 “recovery strategy”, including: • From 1 August: reopen most remaining leisure settings, enable the restart of indoor performances, enable all close contact services to return, and carry out pilots in venues with a range of sizes of crowds. Delayed (see below, 31 July). Implemented 15 August 2020. • From 1 August: employers given more discretion on how they ensured employees could work safely. Implemented. • From September: schools, nurseries and colleges would be open for all children & young people on a full-time basis, while universities would work to reopen. Implemented. • From October: Government intended to allow audiences to return to stadiums, while conferences & other business events could recommence, subject to the outcome of pilots. • The Government’s ambition was to allow “a more significant return to normality”, starting with removal of social distancing, by November at the earliest.

25 July 2020, relaxation	As announced on 9 July, indoor gyms, swimming pools & sports facilities.
31 July 2020	Local lockdown in areas including Greater Manchester, parts of West Yorkshire.
31 July 2020, announcement	PM announcement: plans for most changes on 1 August postponed for at least a fortnight, until 15 August at the earliest. Casinos, bowling alleys, skating rinks & remaining close contact services cannot open; indoor performances cannot resume; pilots of larger crowds in sports venues & conference centres cannot take place. See 15 August.
AUGUST	FURTHER RELAXATION OF RESTRICTIONS, MID AUGUST
1 August 2020	Employers given more discretion on how they ensured employees could work safely (as announced on 17 July).
15 August 2020, relaxations	Casinos, bowling alleys, skating rinks & remaining close contact services can open; indoor performances can resume; pilots of larger crowds in sports venues & conference centres can take place (see 31 July).
SEPTEMBER	TIGHTENING OF RESTRICTIONS
9 September 2020, announcement	New restrictions announced. From 14 September, social meetings with other households limited to groups of 6 ("rule of six"). New rule applies to people in private homes, indoors & outdoors, & places such as pubs, restaurants, cafes & public outdoor spaces. The rule does not apply to schools & workplaces, or weddings, funerals & organised team sports.
9 September 2020	New slogan: hands (wash your hands regularly and for 20 seconds), face (wear a face covering in indoor settings where social distancing may be difficult and where you will come into contact with people you do not normally meet), and space (stay 2 metres apart from people you do not live with where possible, or 1 metre with extra precautions in place).
11 September 2020	Local lockdown in Birmingham.
14 September 2020	New restrictions introduced, "rule of six".

Sources: various. Note the dates mainly refer to England.

Table 2a ECB forecasts for the Eurozone, June 2020, September 2020: baseline forecast

	September 2020			June 2020		
	2020	2021	2022	2020	2021	2022
GDP (%)	-8.0	5.0	3.2	-8.7	5.2	3.3
HICP annual rate (%)	0.3	1.0	1.3	0.3	0.8	1.3
Unemployment rate (%)	8.5	9.5	8.8	9.8	10.1	9.1

Table 2b ECB forecasts for the Eurozone, June 2020, September 2020: mild and severe scenarios

	September 2020						June 2020					
	Mild scenario			Severe scenario			Mild scenario			Severe scenario		
	2020	2021	2022	2020	2021	2022	2020	2021	2022	2020	2021	2022
GDP (%)	-7.2	8.9	3.5	-10.0	0.5	3.4	-5.9	6.8	2.2	-12.6	3.3	3.8
HICP annual rate (%)	0.3	1.2	1.8	0.3	0.7	0.7	0.4	1.1	1.7	0.2	0.4	0.9
Unemployment rate (%)	8.3	7.8	6.6	8.9	11.4	11.2	8.8	8.5	8.0	11.3	12.5	11.2

Sources: *ECB*, "Eurosystem staff macroeconomic projections for the euro area", 10 September 2020.

Table 3a Withdrawal Agreement, main features

Heading	November 2018	October 2019 revisions
Citizens' Rights	• Provides certainty for EU citizens living in the UK, & UK nationals living in other EU countries.	• <u>Basically unchanged</u>
Implementation (Transition) Period	• A time-limited implementation (transition) period agreed until 31 December 2020. During this time, common rules will remain in place with EU law continuing to apply in the UK. • The Joint Committee may, before 1 July 2020, adopt a single decision extending the transition period for up to one or two years (Article 132).	• <u>Basically unchanged</u>: the standstill transition period lasts until December 2020, with the option of extension up to December 2022; the references in the Protocol to transition extension have been deleted, but their legal basis elsewhere in the Withdrawal Agreement remains.
	• The EU and the UK have committed that they will use their best endeavours to conclude and ratify an agreement on the future relationship by 1 July 2020, to apply after the end of the transition period (31 December 2020). • If agreement on the future relationship is not applicable by 31 December 2020, there are two options. o Firstly, a "backstop	

	solution" will apply until such a time as a subsequent agreement is in place (see below). o Secondly, the UK may request an extension of the transition period (see above).	
Financial Provisions	• The negotiated financial settlement covers the UK's financial commitments to the EU & the EU's financial commitments to the UK. A "reasonable" central estimate is around £35-39bn.	• <u>Basically unchanged</u>: although the extension to Article 50 means that the total payment is likely to be in the region of £33bn, not the oft-quoted "£39bn" figure.
Protocol: Northern Ireland/Ireland		• Significant changes.
Backstop	• The key features of the "backstop" are: • There will be a "<u>single customs territory</u>". The UK will align tariffs and rules applicable to its customs territory to the EU's. • <u>Regulatory alignment</u> measures to ensure a "level playing field". These include alignment with the EU's state aid rules, competition policy, labour and social protection, and environmental protection and climate change. • There are additional alignment conditions and checks on goods for Northern Ireland. • Any termination of the Protocol (the "backstop") would be decided by the EU-UK Joint Committee. No unilateral termination.	• <u>The backstop has been replaced</u> with a 'frontstop' special arrangement for NI which will come into force immediately after the end of the transition period. • <u>Customs</u>: the "frontstop" ensures that NI will leave the EU's Customs union along with the rest of the UK, but the UK will have to enforce EU Customs procedures at points of entry into Northern Ireland. • The customs border will, therefore, now be between GB and the island of Ireland, rather than between NI and the Republic of Ireland. This means incoming goods will be checked at Northern Irish ports, not at the internal border. So, the default is that EU tariffs will be applied on goods entering NI from GB, or from the rest of the world (RoW). • There are, of course, exceptions to this. If it can be proved that the goods will not pass into the Republic of Ireland, no tariffs will apply. There will also be a rebate system. If goods are considered "at risk" of moving into EU territory, tariffs will be applied.

		But if they never leave NI, the government will grant a refund. A joint committee will be set up to determine which goods fall within this category. Essentially, the measures will create a dual tariff system at the Northern Irish border, where the default is EU tariffs, but exceptions apply.
Northern Ireland: alignment & additional checks	• Northern Ireland will remain aligned to a limited set of EU rules that are deemed indispensable for avoiding a hard border, namely: VAT and excise, goods standards, Sanitary rules for veterinary controls ('SPS rules'), agricultural production/marketing, state aid rules • The EU's Customs Code will also continue to apply in Northern Ireland within the overall context of the single customs territory between the EU & the UK. • There would be a need for additional checks on goods (industrial and agricultural) travelling from the rest of the UK to Northern Ireland.	• Regulations: NI will also follow the EU's regulatory framework in certain respects, meaning there will be no regulatory or customs border with the Irish Republic. • VAT: in addition to trade tariffs, goods moving across borders can be subject to VAT, a tax added to purchases. Under the new proposals, VAT will apply to goods in Northern Ireland, but not to services. However, Northern Ireland would be able to have different VAT from the rest of the UK, allowing it to align its rates with the Republic of Ireland.
		• Consent: the special arrangements will be subject to the consent of the people of Northern Ireland and include an exit mechanism, with the devolved Assembly being granted the right to opt out of the Northern Ireland-specific procedures on the basis of a majority vote.
		• The Withdrawal Agreement no longer includes a customs union (and accompanying "level playing field" obligations) as the default basis for the future UK-EU relationship, which was included under the backstop.

Table 3b Political Declaration, main features

Issue	November 2018	October 2019 revisions
Trade agreement, single customs territory	• Free Trade Agreement (FTA), with zero tariffs, combining deep regulatory & customs cooperation. • No tariffs, fees, charges or quantitative restrictions across all sectors, with ambitious customs arrangements that…<u>build & improve on the single customs territory provided for in the Withdrawal Agreement.</u> • The Parties envisage making use of all available [trade] facilitative arrangements & technologies. • Technologies may be used for ensuring no hard border in Ireland.	• Economic partnership should through a FTA ensure no tariffs, fess, charges or quantitative restrictions across all sectors with appropriate accompanying rules of origin, and with customs arrangements in line with Parties' objectives and principles. • No reference to the single customs territory (dropped from revised Withdrawal Agreement).
Services	• Liberalisation of services. • On financial services the start of equivalence assessments by both Parties, endeavouring to conclude these assessments by end-June 2020.	• Unchanged.
Free movement	• The principle of free movement of persons between the EU & the UK will no longer apply	• Unchanged.
Fisheries	• New fisheries agreement on access to waters & quota shares	• Unchanged.
Level playing field	• Competition must be open & fair. • Provisions to ensure this should cover state aid, competition, social & employment standards, environmental standards, climate change & relevant tax matters, <u>building on the "level playing field" arrangements provided for in the Withdrawal Agreement</u> & commensurate with the overall economic relationship.	• Competition must be open & fair. • Parties should uphold common high standards applicable to EU and UK at the end of the transition period in the areas of state aid, competition, social & employment standards, environment, climate change & relevant tax matters. • No reference to the "level playing field" arrangements provided for in the Withdrawal Agreement (dropped from revised Withdrawal Agreement).

Sources: (i) *DExEU website*, "Revised Protocol to the Withdrawal Agreement", 17 October 2019; (ii) *DExEU website*, "Revised Political Declaration", 17 October 2019; (iii) *European Commission*, "Brexit: European Commission recommends the European Council (Article 50) to endorse the agreement reached on the revised Protocol on Ireland/ Northern Ireland and revised Political Declaration", press release, 17 October 2019; (iv) Ruth Lea, "The IMF downgrades global growth again for 2019, slowest pace since the financial crisis", *Arbuthnot Banking Group*, 21 October 2019.