The City of London does not yet know what Brexit will mean

CRITICS HAVE described Britain's post-Brexit trade deal with the European Union, signed on December 24th, as "thin". Nowhere is it thinner than on financial services, of which there is scant mention in the accord's 1,255 pages. That should not have been a surprise: it was decided long ago that Britain's future relationship with the EU in finance would be dealt with separately, and later. That the sector was not a priority for Britain's supposedly pro-business Conservative government did raise some eyebrows. But senior Leavers recognised that there were more votes in protecting fishermen than moneymen—and took the view that Britain's leading banks and fund managers were, in the meantime, big and smart enough to look after themselves.

This leaves a big question-mark hanging over the City, London's financial district. It must now wait until January or later to learn what degree of market access its firms will enjoy in the EU in the future.

Britain's departure from the bloc deprives the EU of its overwhelmingly dominant hub in international finance. In 2018 Britain had a roughly one-third share of EU capital-markets activity, around twice the share of the next-highest member, France, according to New Financial, a research group.

Banks in Britain at first hoped to hold on to their full "passporting" rights when the country left, meaning access to EU customers could continue unhindered. But that was quickly ruled out. The best they can now hope for is "equivalence", a poor cousin of passporting that permits access if both sides declare that the other's regulatory framework in a particular area of finance is close enough to be "equivalent". Among the drawbacks of this approach are that the access is somewhat fettered, equivalence is only possible in certain financial sectors, and it can be revoked (at least by the EU) with 30 days' notice.

The two sides have made different offers so far on equivalence. Britain has granted it to EU firms in a substantial number of businesses. The EU, though, has offered only temporary equivalence rights, and in just a few areas it considers crucial for its own financial stability, such as clearing (the centralised transfer of funds and ownership in securities trading). It has, for instance, agreed to an 18-month extension of current arrangements for European banks using London-based derivatives clearing-houses, beginning in January. This means that Britain will start its post-Brexit trading arrangements with the EU with fewer equivalence deals in place than several other global financial centres, including New York and Singapore, according to experts [...].

One reason for the continued uncertainty is that the outcome will depend on how much Britain wants to use its new regulatory freedom to diverge from EU rules—and it is yet to unveil its plans. Rishi Sunak, Britain's chancellor of the exchequer, said on December 27th that his government wants "to do things a bit differently" when it comes to financial rule-making. British regulators, including the Bank of England, have talked of making bank and markets regulation "smarter", by having it determined more by the watchdogs and less by legislation (which in the EU involves all manner of tortuous compromises). The European Commission said in a document released at the same time as the trade deal that it needed to see "a series of further clarifications" on how far Britain planned to stray from EU rules.

The EU sees Brexit as an opportunity to make its financial sector stronger and more coherent. There is renewed interest in kick-starting the bloc's "capital-markets union" project. Already, at least 7,500 jobs have migrated from London to EU financial centres. Officials in Brussels would like to see key functions like clearing move within a few years, too. However, the hustling for business by various EU centres, from Frankfurt and Paris to Luxembourg and Amsterdam, remains balkanised and thus less efficient. It is hard to see any one of them rivalling London in the short to medium term.

Indeed, Britain’s departure means that EU capital markets will become a lot smaller and less developed. The bloc’s share of global capital-markets activity will fall by about a third, to 13%, reckons New Financial.

Britain, meanwhile, will go from being the largest partner in a large bloc to an independent player with around 8% of global activity. Its influence on the global stage will take a knock, in the short term at least. However, ministers in London are talking a good game. They point out that the number of jobs lost to the EU has been far short of initial predictions, which ran to 50,000 or more. A recent survey of 24 large banks and asset managers by the Financial Times found that most had actually increased their headcount in London over the past five years. (Some experts, however, think that many of the London-to-EU job moves will not materialise for some time, and that London’s share of employment could dip in 2021-22.)

Senior Tories also talk of turning London into a more outward-looking financial hub, with closer links to non-EU centres, particularly in Asia and the Middle East. They hope that being cut loose from the EU’s stifling red tape will boost London’s prospects in hot areas of finance, such as fintech and green finance—both sectors in which the City is already among the leaders globally. Ministers also talk of adjusting the rules to make stockmarket listings easier. (Critics worry this will mean lowering standards.) Mr Sunak says he wants to make Britain the best place in the world to do business.

One thing that is clear is that in many financial sectors a lot of EU-related and euro-denominated activity will continue to be done in Britain for now. Last year the country was home to just shy of 90% of all over-the-counter derivatives trading and 84% of all foreign-exchange trading in the EU, for instance. Although the final financial arrangements have yet to be agreed on, it is fair to expect that Brexit will on balance be bad for the City, but not a disaster.

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