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MACRO NEWS

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UK: HEADING FOR A HARD BREXIT AND SCOTTISH EXIT?

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ARTICLE 50: GREAT REPEAL BILL GIVES PARLIAMENT ANOTHER CHANCE TO INFLUENCE BREXIT TERMS

No strings attached: That parliament has passed the Article 50 bill giving government unconditional permission to kick off the two-year divorce proceedings with the EU is a major victory for Prime Minister Theresa May. It enables May to approach negotiations with the EU as she sees fit. If May takes a non-confrontational approach and signals a readiness to maintain a high degree of openness to the UK for EU workers, signalling a soft Brexit, markets could assume that the long-term economic costs will be relatively small. Unfortunately, May's rhetoric up to now suggests that she is likely to heed the populists' call to prioritise migration controls over market access. We still expect the UK and EU to agree to a semi-hard Brexit in the end – one where the UK imposes modest restrictions on EU workers and in turn finds itself excluded from key parts of the single market for services. Through slower growth in trade, investment and migration with the EU, we expect Brexit to reduce UK potential growth to 1.8% – from 2.2% before the Brexit vote. In the case of a hard-Brexit, potential growth could fall to 1.5%.

One more chance for parliament to influence Brexit: To simplify the domestic legal aspects of Brexit, May's government plans to ask parliament to transpose all current EU law into UK law when the UK exits the bloc. May plans to introduce a 'Great Repeal Bill' in the next parliamentary session beginning in May 2017. The Great Repeal Bill is an aside to the Brexit negotiations – it is purely a matter for domestic politics. After repealing the 1972 European Communities Act, parliament will have the power to accept, reject and amend elements of EU law and end the jurisdiction of the European Court of Justice in the UK. In effect, the Great Repeal Bill presents parliament with another opportunity to vote on the Brexit deal. However, parliament's position is weaker this time around while the stakes are much higher. Unlike the recent vote on the Article 50 bill which preceded Brexit negotiations – an opportunity to prevent May from beginning the divorce negotiations – the passing of the Great Repeal Act will have no legal effect on Article 50 of the Lisbon Treaty, which sets out the rules for a member exiting the EU. May now has the stronger hand over the mostly pro-EU parliament. Parliament can no longer prevent Brexit: it can only hope that the threat of MPs blocking the Great Repeal Act is enough to encourage May to go for a softer exit.

IS A SCOTTISH INDEPENDENCE REFERENDUM BACK ON THE CARDS? NOT JUST YET

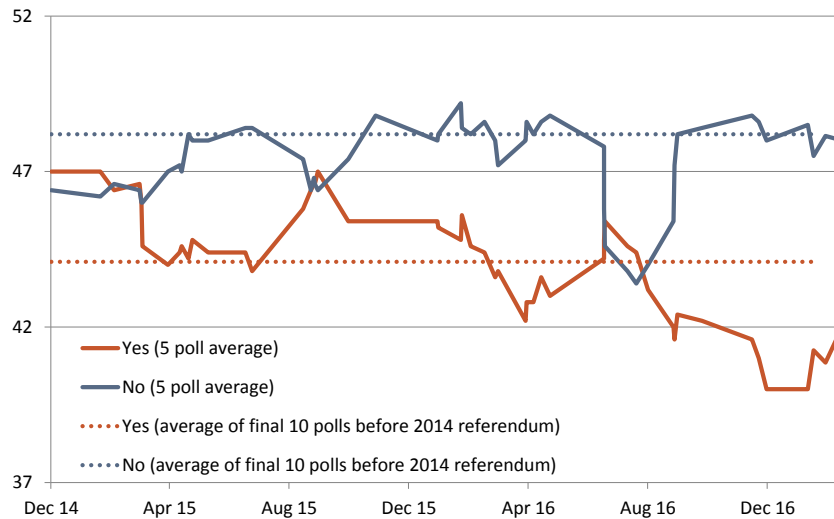
Sturgeon versus May: SNP leader Nicola Sturgeon has announced that she wants to hold a second referendum on Scottish independence between autumn 2018 and spring 2019. Now that May has a de-facto free rein over Brexit, the risk has risen that the UK heads for a hard Brexit and Scotland leaves the UK. Having voted 62% in favour of remaining in the EU, Scotland is the most pro-EU region in the UK. But UK parliament must approve a second referendum first. The Times reports that May intends to block a second referendum until Brexit negotiations are complete. Sturgeon may be betting on such an outcome as a tactic to raise support for independence and/or as a ploy to soften May's stance on Brexit. At the very least, by posturing for a second referendum, the SNP can help bolster its chances to retain its solid majority of Scottish seats at the 2020 UK general election and secure another win at the 2021 Scottish parliament election.

Polls suggest Scots back remaining in the UK: Since the first referendum (see Chart 1), support to remain in the UK has held broadly stable at 48% – the same level of poll support before the 2014 referendum that ended with 55.3% of Scottish people voting to remain in the UK. Meanwhile, support for Scottish independence has fallen by around 5ppt since 2014. At the current level of c42% in opinion polls, support for independence is c2ppt below the 44% support shown in the pre-2014 referendum polls (support for 'yes' in the 2014 referendum was 44.7%). Only one in the last sixteen opinion polls shows a majority of Scottish people in support of independence. A second 'no' vote would put the question to rest for at least a generation. For now, there is a good chance we are observing political games playing out at the highest level, rather than Scotland heading towards an exit from the UK.



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Chart 1: Opinion polling for Scottish independence



Question: Should Scotland be an independent country? Result from 18 September 2014 referendum: 44.7% = yes, 55.3% = no.

Source: Various, Berenberg calculations

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