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UK: 8TH JUNE 'BREXIT' ELECTION RAISES RISK OF 'HARDER' EU EXIT

Berenberg Macro Flash

PM May seeks to strengthen her mandate: Rebuking previous promises not to hold early elections, Prime Minister Theresa May today announced that she wants to hold a snap general election on 8th June. If she wins the election, she may find it easier to pursue a tough stance in talks with the EU. This could add to the risk of a harder Brexit.

80% probability that the Conservatives will win: Tomorrow, the House of Commons will need to back early elections with a two-thirds majority. All key party leaders have today voiced support for holding a general election. According to opinion polls, May can expect to win handsomely and strengthen the Conservatives' current seventeen seat working majority in the House of Commons. Latest polls show the Conservatives some 21 points ahead of the disoriented Labour Party, led by far-left Jeremy Corbyn, and 12 points ahead their support in polls before the 2015 general election. We thus see an 80% chance that the Conservatives either maintain or increase their majority on 8th June. Since neither Labour nor the Liberal Democrats have clear policy platforms in place from which to campaign, and are so far behind the Conservatives, it is almost inconceivable that they can muster enough support within the next seven weeks to win an election outright. We see a 20% chance of a hung parliament, driven by strategic anti-Brexit votes from defecting pro-EU Conservatives.

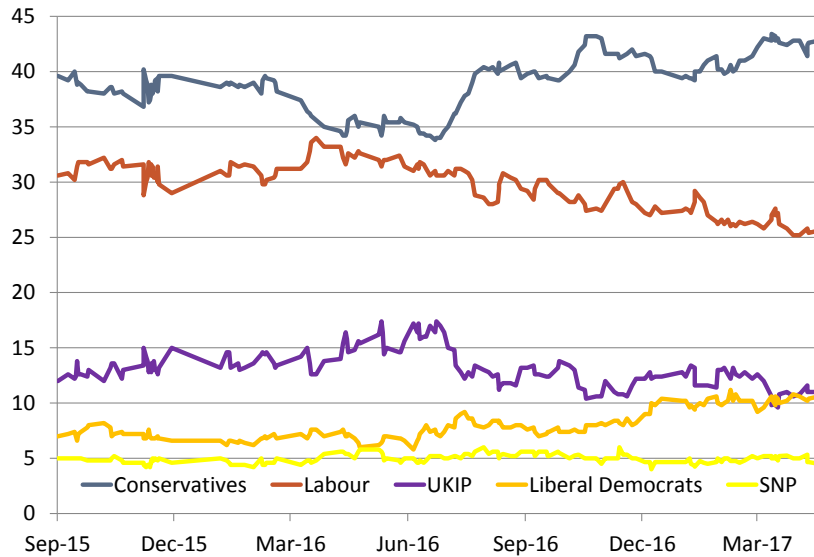
May takes a calculated risk: The economic numbers continue to come through strongly and support for the Conservatives is at post-Brexit vote high, if there was ever a time to call a snap general election it is now. PM May is taking a strategic gamble to strengthen her hand. All key opposition parties against the Conservatives want to either soften Brexit (Labour and Liberal Democrats) or stop it (Scottish National Party). An election win for the Conservatives thus strengthens May's control over the UK's Brexit strategy. It can also align the UK election schedule with the timeline for the Brexit negotiations. With a general election this year, Brexit (including a transitional period) would likely be over by the next election in 2022. By weakening the hand of the pro-EU parties, the risk of a harder Brexit that places hard restrictions on migration and ends with limited preferential trade terms post-Brexit increases a little.

Implications for the UK economy: A vote for the Conservatives is de facto a vote against the soft Brexit proposed by other key parties. In our base case (80% chance) that the Conservatives win the election, the heightened risk of a harder Brexit shifts the risks to our long-term outlook – real GDP growth of 1.8% yoy from 2.2% pre-Brexit – slightly to the downside. The near-term economic implications would be relatively small as a win for the Conservatives would not change the status quo much. On domestic policy, a fresh mandate for May could change fiscal policy a little, with the gradual consolidation driven by tax hikes rather than spending cuts. The election will be concluded before any major negotiations between the UK and EU begin. A hung parliament (20% chance) would create significant near-term uncertainty. Remember, the UK has already triggered Article 50. The two-year countdown to conclude the Brexit divorce is ticking now. A hung parliament could leave the UK divided entering negotiations with the EU, raising the risk of exit without a deal because the UK cannot agree a strategy in time. In this sense, a hung parliament would create some downside risks to the medium-term economic outlook. However, if a hung parliament were to lead to a softer Brexit strategy, it may turn out to be positive – relative to our base case of 1.8% growth – for the economy in the long-run.



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Opinion polls for the next UK general elections



Support for political parties in %, average of last 5 opinion polls.

Source: National opinion polls

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